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# *The* Accounting Review

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# The Accounting Review

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## SOME CURRENT PROBLEMS IN ADMINISTERING THE RETAIL INVENTORY METHOD


CARL N. SCHMALZ


ANY DISCUSSION of the retail inventory method may well begin with a brief statement of the important characteristics and objectives of the method. Such a statement should include the five points which follow:

1. The retail method was created to meet the inventory valuation problems of department and specialty (women's apparel) stores, which constitute a distinct type of trading enterprise with valuation problems quite different from those of manufacturers, public utilities, railroads, and other kinds of business organization, and even from those of some other types of retail concern. Department and specialty stores buy and sell merchandise, but for the most part do not compound or process merchandise. Large department and specialty stores use the retail method almost universally, but only for trading departments and not for departments where manufacturing takes place or which deal largely in personal services. One could point out, also, how the characteristics of department store merchandise differ from those of goods sold by other kinds of retailer which do not use the retail method, but that would lead into by-paths somewhat irrelevant for present purposes.

2. The retail inventory method provides a means of estimating the value of merchandise inventory at cost-basis prices without actually referring to the cost prices paid for those goods and recorded on invoices, in code on price tickets, or in price books; and without seeking to learn the prevailing wholesale market prices for the same or similar goods. In fact, the method is designed to yield usable estimates of cost-basis values for merchandise which, because of its physical condition or style characteristics, literally has no exact counterpart in wholesale markets, so that market price figures simply cannot be obtained.

3. The retail inventory method involves the recording of beginning inventories and purchases at both cost and retail prices, the marking of prices on the goods at retail only, the recording of all price changes, the taking of inventories at retail prices only, and the reduction of inventory valuations to cost basis by use of the average mark-up percentage. The keeping of complete records, of course, implies that a book inventory may be arrived at at any time.

4. The problems connected with valuing inventories at the close of accounting periods is essentially a problem of assigning gross margin or profit to accounting periods. By varying the values secured one does not vary the total margin or profit involved; he merely varies the division of that margin or profit between accounting periods.

5. Whenever there is doubt as to the valuation to be accepted, it is more conservative to throw the profit forward into a period in the future rather than to take it in a period which has closed. For instance, if there is any doubt as to whether a profit is to be earned, it is undesirable for one to pay a tax on that profit, to pay a portion of that profit out in dividends or withdrawals, or to mark up common stock valuation because of it.

All the questions of policy or practice relating to the retail inventory method have to be decided in the light of these underlying facts and principles.

Perhaps it should be noted, also, that

largely through the work of the Controllers' Congress, National Retail Dry Goods Association, and the influence of the book published in 1925 by Professor McNair, practice in applying the retail method has been to some degree crystallized, so that one properly may refer to *the* retail method. Crystallization, however, has occurred only partially. The method is still evolving and has not yet reached maturity.

This paper was undertaken primarily to describe and discuss the problems which have arisen recently in administering the retail method. My consideration of these problems involved following further several old lines of thought, and this leads me to suggest certain changes in procedure under the retail method.

Effective presentation of the current problems requires a brief description of several aspects of the procedure generally followed at present, that description brings one naturally to a statement of one of the suggested changes in procedure, and both provide the foundation for a rather rapid handling of the current problems. This paper, therefore, proceeds with:

First, a brief description of certain key procedures under the retail method now widely used and looked upon as standard, together with an explanation of one suggested change;

Second, descriptions and discussions of certain current problems of department store controllers in administering the retail method, with an explanation of a second suggested change; and

Third, summary and conclusions.

For the description of existing procedures I have prepared a number of charts of which you have copies. These charts indicate graphically the operation of the retail method under various sets of conditions frequently encountered in practice.

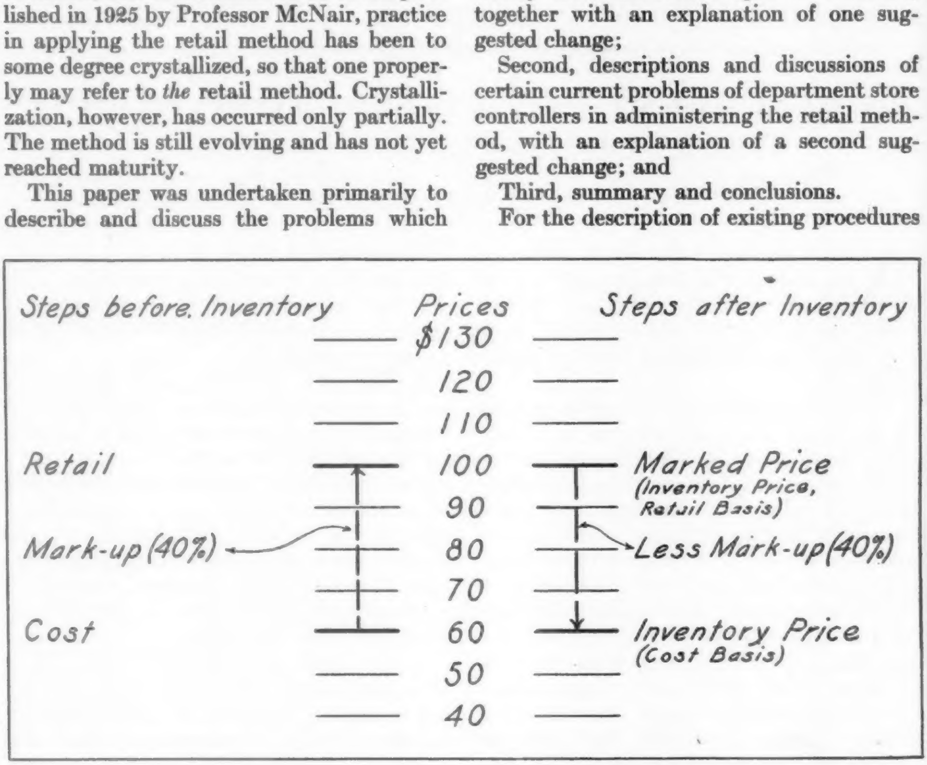


Chart 1. Operation of the Retail Inventory Method When There Are No Additional Mark-ups and No Mark-downs

The first chart represents the simplest possible condition under which the retail method might be used: no increase in price subsequent to purchase and no decrease in price before inventory time. Under these conditions the chief advantages of the retail method are clerical; its use obviates the necessity for consulting invoices or a price book, and for placing the cost price on the goods in code. Also, it may have certain ad-

vantages from the standpoint of merchandising psychology by focusing attention upon retail prices. Under the simple conditions represented in Chart 1 the retail method values the closing inventory at actual cost prices.

In the second chart a single complication is introduced, the one most frequently encountered in department stores when general price levels are stable; namely, no increases in price after purchase but some decrease in value and in price. Under these conditions the retail method automatically puts into effect the familiar rule of inventory valuation: cost or market, whichever is lower. It does this, even though the merchandise inventoried at the close of the period may not be duplicated in condition or style in the wholesale markets, by proceeding under the assumption that the goods in stock are worth at cost-basis prices, their marked retail value less the percentage of mark-up placed upon them when they were new; in this case 40%. The retail method, therefore, creates for the merchant an estimated or hypothetical market price when no actual market price exists.

Chart 3 indicates the operation of the retail method under conditions somewhat less frequently found; namely, when some increase in price, but no decrease, occurs between purchase and inventory. This situation, though not encountered with great frequency, illustrates pointedly one of the important features of the retail method. The chart shows how, under the method, the percentage mark-up taken when the goods are first placed in stock is increased as the retail price is raised; and how the application of this larger, or total, mark-up percentage to the retail price found on the goods at inventory time produces a cost-basis inventory valuation equal to the original cost price. Here again the system values the inventory at cost or market, whichever is lower.

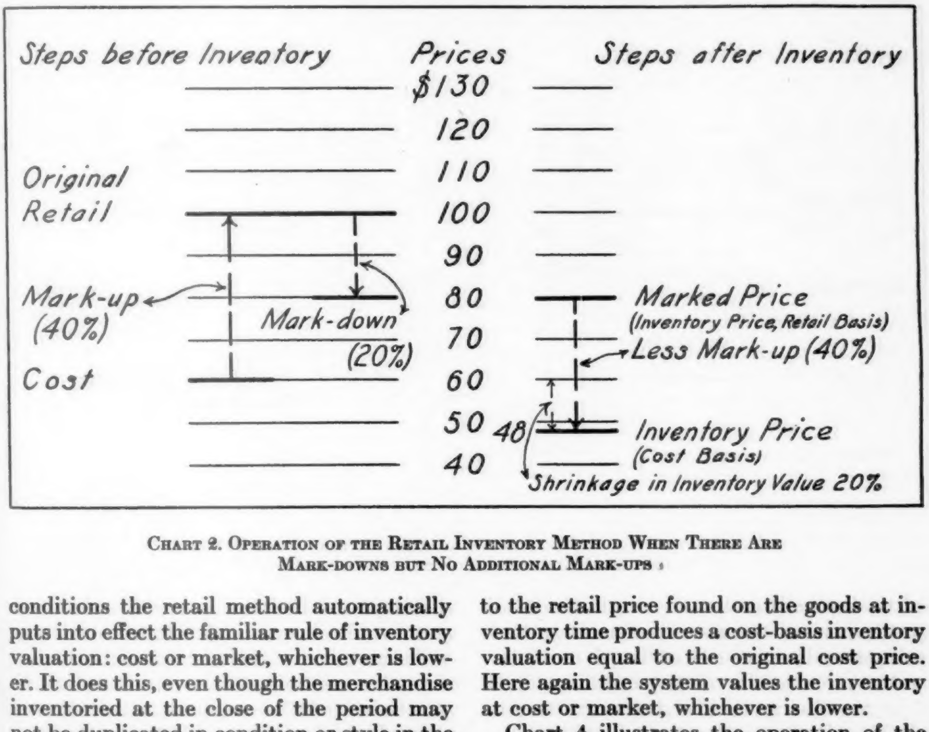


Chart 2. Operation of the Retail Inventory Method When There Are Mark-downs but No Additional Mark-ups

Chart 4 illustrates the operation of the retail method when increases in price subsequent to the first retail pricing of the goods are in part offset by reductions. You will recall that, under the retail method as generally used, reductions in price which do not bring the price below the first-marked retail price are treated not as mark-downs but as additional mark-up cancellations. In other words, such reductions in price above the

level of the original retail price are permitted to reduce the mark-up percentage. Thus their effect is to hold the cost-basis valuation of the closing inventory at actual cost and to prevent its going below actual cost until the retail price drops below the original retail price, at which time the procedure indicated in Chart 2 comes into play.

The working of the method is made clear by the chart. The standard method indicated by the heavier lines results in the computation of a mark-up percentage which, when applied to the price marked on the goods at inventory time, yields a cost-basis price equivalent to original cost.

At this point it will be helpful to digress from the description of the standard method to present one of the recommended changes.

According to the example in Chart 4, the standard retail method values the closing inventory at cost, $60. In line with the principles stated at the beginning of this paper, one must inquire whether, in view of the price changes assumed in the example, $60 should be the cost-basis price of the merchandise in stock, merchandise which has been reduced in retail price from $120 to $105. Manifestly, if the goods had been found in stock marked $120 they would have been assigned a cost-basis inventory value of $60. The mark-up would have been 50%, just as in the example of Chart 3. Is it reasonable to assume that, in the face of a $15 reduction in retail price, the cost-basis price of the goods still is $60?

I think that the answer to this question depends upon the reason for the reduction in retail price. If the reduction was made solely to meet established lower prices of competitors based on lower wholesale prices or on some competitor's willingness to accept a smaller margin, the $60 valuation is conservative and acceptable. Presumably the difference between replacement cost and marked retail price is still 40% and $60 represents the lower of cost or market valuation.

On the other hand, if the reduction was made because of a depreciation in the quality of the goods themselves, or because of obsolescence in style or a maladjustment of the goods to local demand, 50%, the total mark-up taken, measures the difference between the current marked retail price and

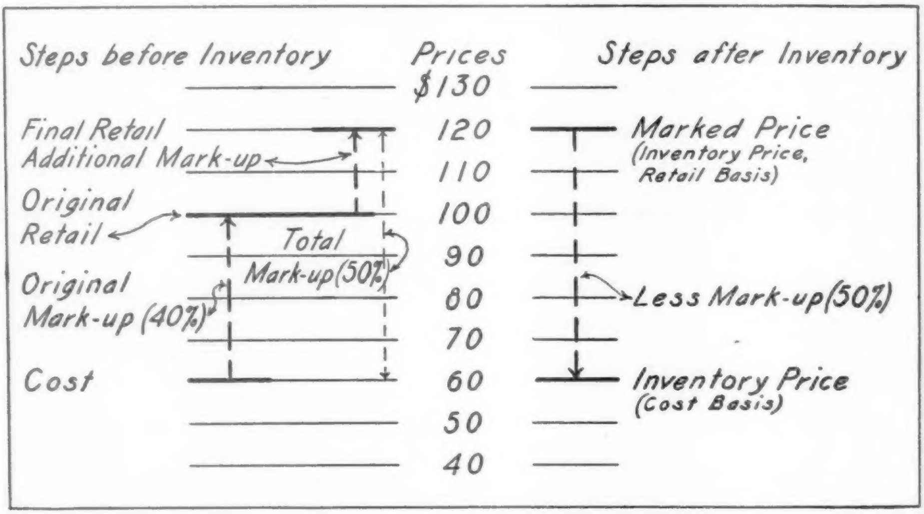


CHART 3. OPERATION OF THE RETAIL INVENTORY METHOD WHEN THERE ARE ADDITIONAL MARK-UPS BUT NO MARK-DOWNS

the cost-basis value of goods similarly depreciated in terms of the prices prevailing when the goods were bought, a time at which prices were lower than they are now. This mark-up percentage leads to a valuation of \$52.50, which is below actual cost by 12½%, the amount of depreciation indicated by the reduction in retail price. It seems to me that the use of any valuation above \$52.50 involves the anticipation of profits from the market rise.

Please remember that we are considering up percentage; and the portion carrying the price below the original retail price being treated as a mark-down precisely like any other mark-down (See Chart 2).

Applying the standard method to the conditions assumed in Chart 5, the inventory price of the merchandise is the marked retail price (in this case \$90) less the original mark-up (40%), or \$54. In other words, according to the standard method, the fact that this merchandise was once thought to be worth \$120 at retail, and the fact that

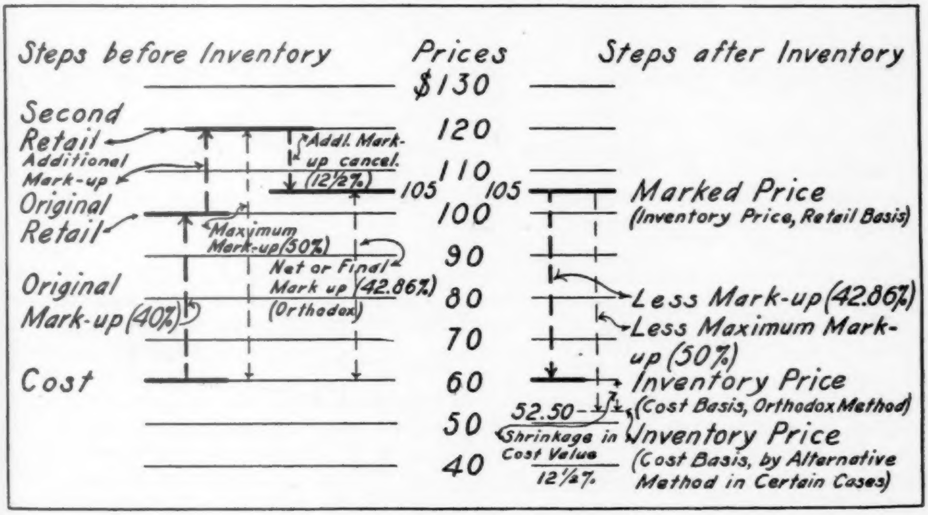


CHART 4. OPERATION OF THE RETAIL INVENTORY METHOD WHEN THERE ARE ADDITIONAL MARK-UPS, ADDITIONAL MARK-UP CANCELLATIONS, BUT NO MARK-DOWNS

only reductions taking place above the level of original retail price.

Before attempting to settle this question finally, let us look at Chart 5 which presents the standard method of handling closing inventory valuation where mark-ups occur after the goods are first placed on sale and where reductions in price before inventory time carry the retail price below the original retail price. Such reductions, according to the standard method, must be divided into two parts: the portion bringing the retail price down to original retail value being treated as an additional mark-up cancellation which is permitted to reduce the mark-

it was once marked up by 50%, are treated as of no significance at inventory time, and the goods are valued precisely as if the price had never been above \$100 and the mark-up never above 40%.

Now whether this procedure is correct seems, again, to depend upon whether the reduction reflects depreciation of quality, obsolescence of style, or maladjustment of goods to demand (poor selection). If the reduction does not reflect any of these things, but does reflect market price declines solely, presumably the cost-basis price of the goods is \$90 (marked retail) less the normal mark-up (40%), or \$54. But if depreciation of

quality alone is responsible for the reduction, the goods surely are worth less than $54, presumably an amount below $60 (actual cost) by the degree of depreciation which has occurred (25%), or $45.

This valuation would be secured if procedure under the retail method were changed as suggested in discussing Chart 4, so that all reductions in price which reflect deterioration or obsolescence are treated as markdowns, regardless of where they occur with reference to original retail price. I recommend this change of procedure.

Perhaps note should be made of the fact that, in reality, the suggested change involves not the question, "Should we refuse to allow any price reduction to lower the mark-up rate?" but rather the question, "What test should we apply in deciding what price reductions are to lower the mark-up rate?" Under the existing standard procedure whether reductions do, or do not, affect the mark-up rate depends upon whether they take place above or below the original retail price. Under the recommended procedure the test is the reason for the price reduction, as well as where or when it takes place. If reductions reflect physical deterioration, style obsolescence, or faulty selection of merchandise, they may not ever be handled so as to produce a lower mark-up percentage; if they do not reflect this sort of reduction in what may loosely be called intrinsic value they may operate to decrease the mark-up rate if they occur above the level of original retail price.

It may be noted that this rule is no more difficult of enforcement than the present rule. The presumption is that every reduction reflects deterioration and is a markdown. The buyer must show cause for its classification as a mark-up cancellation, and to do that he must demonstrate that the reduction occurs entirely above the level of original retail and that the goods are like new.

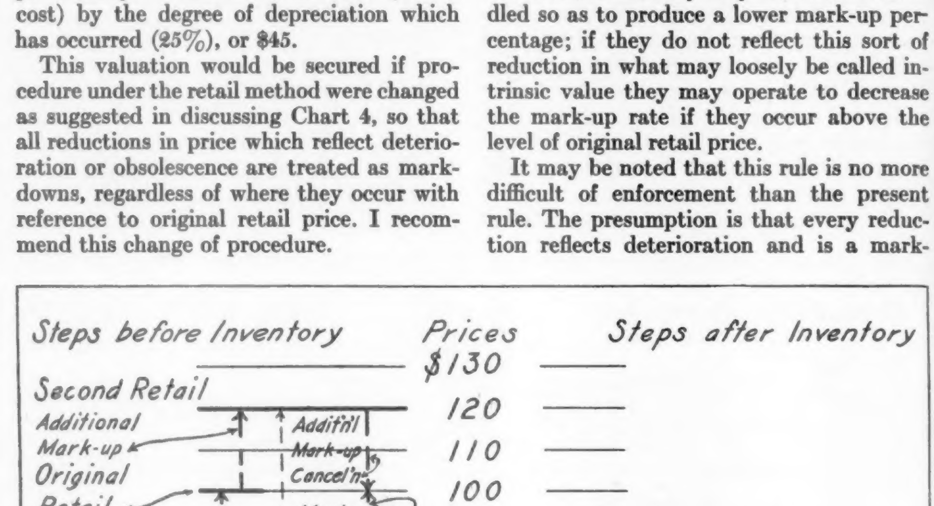


CHART 5. OPERATION OF THE RETAIL INVENTORY METHOD WHEN THERE ARE ADDITIONAL MARK-UPS, ADDITIONAL MARK-UP CANCELLATIONS, AND MARK-DOWNS

In considering the problems which the depression has brought to the department store controllers administering the retail inventory method one should bear in mind the fact that the method was designed specifically to meet the conditions created by price changes, especially price declines. The retail method is largely a department store de-

velopment. These stores deal so largely in merchandise subject to rapid obsolescence because of changes in fashion that they typically encounter falling prices.[1] Moreover, in 1918 to 1922, when the method as we know it was worked out, department store controllers had vivid recollections of sharp fluctuations in prices, both upward and downward. It was only natural for them to build into this new system provision for the automatic handling of price changes. They seem to have done their work well, for, in so far as I have been able to learn, the method has met satisfactorily the conditions which have prevailed since 1929.

From the beginning of the depression until April of this year, when department store prices reached their lowest point, the problems of administering the retail method grew largely out of the decline in prices; since April executives have encountered somewhat different problems arising partly from the increases in prices but more, apparently, from the speculative buying which was indulged in so freely during the past summer. In this paper the two sets of problems will be discussed separately.

Although the problems which arose between 1929 and April, 1933, were associated with falling prices, apparently they were due not to falling prices directly or to any failure of the retail method to arrive at fair valuations, but to the fact that falling prices increased the temptation, always present to some degree among buyers and merchandise executives, to try to manipulate the records so as to show better results than those warranted by the facts.

Please do not infer that buyers and merchandise executives are typically unethical. They are not; but many of them have ideas differing from those of accountants and controllers as to the desirability of making the books reflect conditions accurately. In almost every large store one normally finds a few people who want to put their best foot forward by beating the system. I have never met a controller who did not fight this tendency to the best of his ability, but I have met merchandise managers who openly encouraged the tendency. In fact, I recall clearly one merchandise manager telling me in the presence of twelve or fifteen people, "Show me a buyer that manipulates and I will show you a good buyer."

I have no facts on the frequency with which attempts at manipulation came up before 1929, or with which they have come up since that time; but in several stores the tendency to try to improve on the facts has been troublesome, and surely during times like these, when profits have vanished and when falling prices have made mark-downs and gross margins unusually difficult to control, one might expect buyers and merchandise men to make every effort to produce good statistical showings. In my judgment, however, there has been little, if any, increase in the amount of manipulation actually achieved.

The forms of manipulation which have come to my attention and which seem to have been encouraged by declining prices are three in number, and one of them is based on the prevailing rule that reductions in price above the level of first-marked retail price should be handled so as to reduce the mark-up rate. Associated with them is a fourth procedure which is quite legitimate but which some controllers have looked upon as manipulation and which I present to you because of its interest.

In one store buyers have attempted to reduce the amount of mark-downs shown on the books (and incidentally to overvalue their inventories) without actually reducing the amount of their price reductions by taking advantage of the rule that, when the price of merchandise is increased by an additional mark-up as represented in Chart 3 the price of that merchandise later may be reduced by a mark-up cancellation equivalent in amount to the additional mark-up (See Chart 5). These buyers did this by simply setting the first-marked retail price at a level below that at which they intended to sell the merchandise, and then immediately putting through an additional mark-up

[1] In 1932 mark-downs in the department store business typically amounted to 9.6% of sales. In 1926 and in 1930, respectively, the percentages were 6.7 and 7.6. Bulletin No. 91, Bureau of Business Research, Harvard Business School, page 1.

to bring the price up to the intended selling price. Of course this procedure resulted in an original mark-up percentage somewhat lower than that which otherwise would have been secured.

Many stores, if not most stores, attempt to prevent manipulation of this sort by controlling the percentage of mark-up on individual invoices. Presumably, therefore, buyers must have attempted this particular form of manipulation chiefly in instances when they were getting a fairly sizeable mark-up, so that the lower original mark-up percentage would not arouse suspicion.

This particular procedure is, of course, not to be permitted even under the existing rules for the retail method which imply that the initial mark-up shall carry the retail price to a level representing the buyer's best judgment as to the price at which the goods should be offered for sale. Nevertheless, the manipulative procedure would lose practically all its significance if the two changes which I have in mind were adopted.

The change already described would wipe out mark-up cancellations due to deterioration of the merchandise itself, and hence would remove temptation to create a body of additional mark-up against which such cancellations could be offset, and it seems likely that the great bulk of mark-downs (which buyers wish to understate) are due to deterioration of the merchandise.

The temptation to try this particular form of manipulation would be still more effectively removed if the second change to which I have alluded were to be adopted.

At present, a change in retail price taking place above the original retail price is allowed to affect the mark-up percentage, whereas a change taking place below the original retail price is not allowed to affect the mark-up percentage. Whenever initial mark-up is less than that required normally to cover expense and profit, this rule yields a cost-basis value of the closing inventory above the value which allows the normal mark-up, in other words, it overvalues inventory; and whenever initial mark-up is more than that normally required, this rule yields a closing inventory value unnecessarily conservative. Both disadvantages can be eliminated if the rule is changed to substitute "price providing normally required mark-up" for "original retail price." With this revision in the procedure, which I recommend,[2] the form of manipulation under consideration would not be possible, for no mark-up cancellations would be allowed below the price of normal mark-up. Hence, there would be no temptation to build up additional mark-ups below the price of normal mark-up.

The second method of manipulation, the use of which may have increased during the period of declining prices, is one which has troubled department store controllers for years; namely, that of indicating on the invoice one retail price and marking the price ticket or tag at another and higher price. By this method, if the merchandise is sold at the retail price indicated on the tag no additional mark-up is reported and the amount by which the marked price exceeds the invoice retail price is allowed to create an unofficial reserve for mark-downs. The amount of this reserve presumably is recorded privately by the buyer, who then can take mark-downs to an equivalent amount without reporting them, or who, if he chooses, can take cash or merchandise to an equivalent amount without producing a stock shortage.

This procedure, of course, is absolutely unwarranted. It not only results in false records but represents a breach of discipline which is unforgiveable. It is not knowingly permitted in any well-run store and practically all stores have set up controls in an attempt to prevent it. Among these controls are the requirement that all marking and remarking be done in a central marking room or by employees of the central marking room, the requirement that no price tags or tickets be permitted in selling departments, the requirement that all price tags be printed and that wrappers refuse to wrap merchandise without a machine-made price ticket, and the requirement that invoices and price ticket requisitions be checked for agreement

[2] The recommendation results from a suggestion by Professor McNair.

by a marking room employee not subject to the buyer's influence and perhaps in a location not accessible to the buyer. Increased vigilance and strict enforcement of rules such as these appear to be all that is necessary to eliminate this particular difficulty.

The third method of manipulation likewise is well known to controllers, but appears to have gained some additional currency during the last few years. It also involves the attempt to avoid recording mark-downs. In certain respects the method is quite sound and acceptable. Its weakness lies in the fact that there is practically no way of insuring that the method will be used in the sound and acceptable manner, for one can use it so as to build up unofficial reserves for mark-downs or potential stock overages to offset the shortages which would result from unrecorded mark-downs.

The opportunity for using this third procedure arises from the fact that in many stores identical merchandise is sold at different prices at different times. In a men's shirt department, for example, a given style number of shirt may be sold regularly at $2, but from time to time it may be offered in special sales at $1.59. Even though the special sale is in effect for but a few days the total amount of goods sold during these few days may equal or exceed the total amoung sold during several weeks or months of selling at the regular price. Frequently, also, the merchandise for both regular and special selling is purchased at the same time in a single lot.

In such cases some buyers attempt to mark a portion of the goods at one price for regular selling and another portion of the goods at the lower price for special selling. This has the rather obvious advantage of avoiding remarking of the goods intended for special selling before the sale, and perhaps remarking a second time some goods remaining after the sale; and it involves no deception whatever because the intention when the goods arrive is to sell them in fairly definite proportions at two different prices.

The danger in the method arises if regulations such as those described in discussing the preceding manipulative procedure are not strictly enforced. Identical merchandise at two prices is carried in the stockroom. If the buyer has intentionally (or unintentionally) caused too large a proportion of the merchandise to be marked at the lower price and too small a percentage at the higher price, the stock marked for regular selling will be exhausted before the special sale takes place, and the merchandise marked at the lower price for special selling can be brought out and sold at the higher price. This procedure would be quite satisfactory if the merchandise were remarked in the regular way and a mark-up put through for the increase. The interests of the buyer at the moment, however, may favor remarking the merchandise surreptitiously and not taking the mark-up, or even selling the merchandise without a price mark at the higher price without taking the mark-up. This latter procedure presumably would not arouse great suspicion on the part of customers because there would be no departure from the price marked on other identical items in the department and indicated on existing signs in the department.

Thus, in the absence of strict control and discipline, this method may make it possible for buyers to manipulate the records.

The fourth procedure suggested by buyers and merchandise men has had, to some controllers, the appearance of attempted manipulation, although it is quite correct and proper. Its suggestion grew directly out of the rebates which buyers have been able to secure in unusual number from manufacturers or other sources of supply during the period of falling prices.

The rebates seem to have been secured rather frequently by buyers who bought merchandise at a given price and marked it at a retail price reflecting the usual mark-up; and who then, before the merchandise was sold, were faced with offerings of identical merchandise at lower retail prices bought by competitors at lower cost prices reflecting declines in raw material costs, wages, or what not.

When such rebates have been secured, controllers have been faced with the ques-

tion, not answered in the standard rules for the retail method of inventory, "How should these rebates be handled? Should the amount of the rebate be treated as a deduction from the accumulated cost inventory; or should it be assigned a retail value based on the average mark-up to date and treated as a reduction from both the accumulated cost inventory and the accumulated retail inventory? If the latter, should the amount of mark-downs taken be reduced by this change in accumulated retail inventory?" Buyers and merchandise people, by and large, seem to have favored the second alternative. At least one controller with whom I have talked was frankly puzzled and did not know what to do, but finally decided that the first method should be used and no retail value assigned to the rebate.

In my judgment the positions of the buyers and merchandise men were right in this instance.

If the rebate is carried to the books at cost values only, the effect is to lower the accumulated cost inventory and leave the accumulated retail inventory unchanged, thus increasing the mark-up percentage. At inventory time this mark-up percentage will yield a cost-basis valuation for the closing inventory smaller than actual cost by the amount of the rebate and by the cost value of any mark-downs taken. This procedure will tend to understate the cost-basis valuation of the closing inventory in situations like the one described; although it will be correct where a rebate is intended to correct the cost price only and is accompanied by no change in the retail price. The operation of this procedure is indicated graphically in Chart 6.

If, on the other hand, the rebate is allowed to influence both the accumulated cost figure and the accumulated retail inventory figure, the percentage of mark-up presumably being the average mark-up for the department to date, the effects will be to hold the mark-up percentage steady and to yield the same cost-basis closing inventory value as would be secured if the mark-down were taken and no rebate were secured. There seems to be no reason why the fact that the manufacturer has given a rebate should make it necessary to value the goods at a lower cost-basis price than would be correct if no rebate were secured. By the retail inventory method, rebate or no rebate,

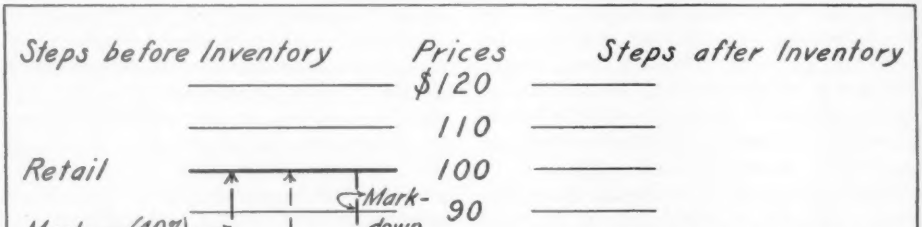


Chart 6. The Handling of Rebates Under the Retail Inventory Method

a store seeks to set an estimated market price lower than the actual cost by the amount of any market decline which takes place. If a rebate is secured, a store merely transfers the inventory loss to the source from which the goods were purchased and hence it moves the actual cost down to meet the estimated cost-basis market price.

Under this procedure, it will be necessary to put through a mark-down cancellation equivalent to the retail value of the rebate if the retail price on the goods has been reduced by a mark-down before the rebate was received. Whether this step is necessary or not, this handling of the rebate means that some reductions in retail price will not be included in the mark-down figure. The record of mark-downs, therefore, becomes not a statistical record of all price reductions (other than mark-up cancellations, discounts and allowances) but merely a record of reductions essential in arriving at the proper estimated cost-basis valuation of the closing inventory.

If the retail value of the goods continues to drop for any reason, including the competition of goods bought at still lower cost prices, mark-downs taken to meet competition will operate to reduce the new cost basis value in the regular way; and if physical deterioration and/or style obsolescence has occurred in addition to the wholesale price decline compensated for by the rebate, mark-downs will exceed the retail counterpart of the rebate, and the estimated market price arrived at under the method suggested in Chart 6 will be lower than the new cost price.

For the sake of completeness, perhaps it should be noted that some stores achieve the same result by crediting the accumulated cost inventory and the accumulated retail inventory at the actual cost price and the existing marked retail price, and then debiting both items at the new cost price and whatever retail price the buyer decides to carry on the merchandise.

This discussion has had to do only with rebates accompanying declines in the retail prices of the goods concerned. Some rebates, such as those received for selling a given quantity of merchandise during a given period, do not accompany any decline in retail values and represent merely a reduction in cost. They should be treated as deductions from accumulated cost inventory only.

So much for the problems which arose when prices were falling.

Since the tide of prices turned in April, three different problems have come up, and the most important of these again raises the question of mark-up cancellations.

During the summer, as you know, in one way or another a great many merchants were induced to buy merchandise speculatively for the rise in price which was to result from a governmentally stimulated recovery and artificial depreciation of the dollar, chiefly, I fear, the latter. The purposes of those in power were achieved in part, and much speculative purchasing was done by department stores. As this low-cost merchandise was brought into the stores, the general tendency seems to have been to mark it up by an unusually high percentage, say 5% of sales more than the usual mark-up. Later on, as the fall business developed it was found that people were unwilling to pay these higher prices, and the long mark-ups placed on the goods during the speculative enthusiasm of the summer were reduced. Immediately controllers were faced with the question, "Should these reductions in exuberant mark-ups be treated as mark-downs or as mark-up cancellations?" Under the orthodox procedure, of course, they would be treated as mark-downs, as is indicated by the heavier lines in Chart 7.

If one remembers that the purpose of the retail inventory method is to arrive at fair cost-basis valuations of the closing inventory under the principle that the lower of cost or market prices are to be taken, he must conclude that the reductions mentioned should be treated as mark-up cancellations. If they are treated as mark-downs, the cost-basis price of the merchandise will be reduced below actual cost. Clearly there is no need for doing that because, in many instances, actual replacement prices in the market apparently are higher than the actual cost price, and I believe it safe to say that in al-

most no instances are the market prices lower.

Of course, it is assumed that the reductions in question are taken to correct over-enthusiastic marking up and not to reflect any deterioration in quality or any obsolescence of style. We are, therefore, faced merely with an application of the old principle: If a reduction should be reflected in a lower estimated cost-basis value, it should not be allowed to reduce the percentage of mark-up; but if a reduction in price should not be reflected in a lower cost-basis valuation, it tion takes place with reference to the original retail price (or better, the price of required mark-up) but also by asking whether the reduction represents conditions ordinarily dictating a reduction in the estimated cost-basis value.

Please understand that I am not attempting to say that these recommended revisions in the retail method will be accepted by the income tax administration. I do believe, however, that if the changes are sound for store management they are sound and fair for tax purposes.

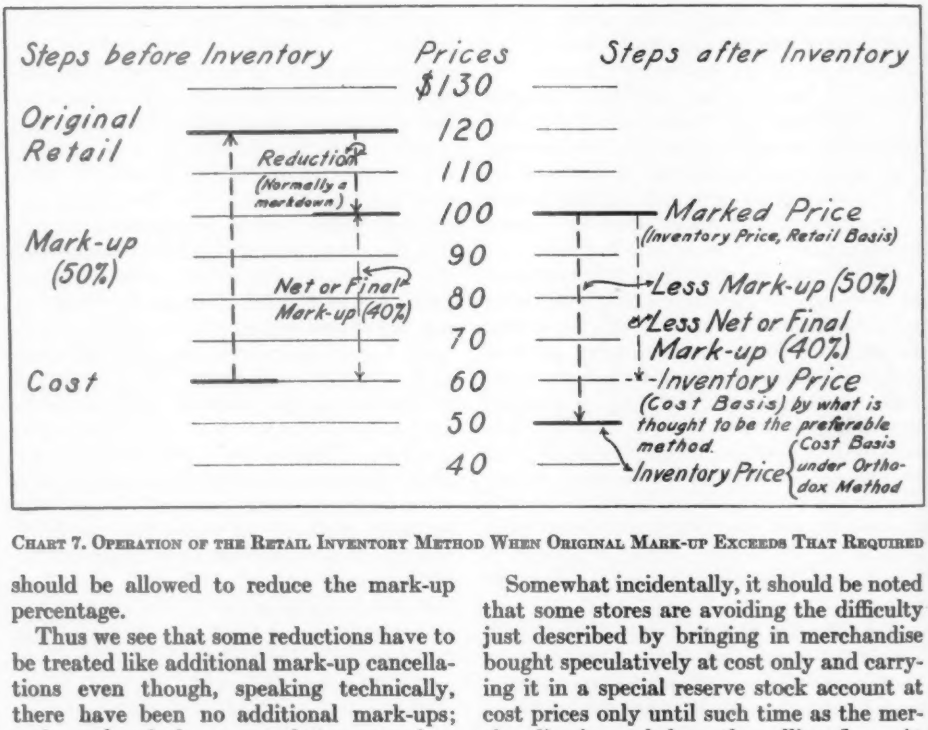


CHART 7. OPERATION OF THE RETAIL INVENTORY METHOD WHEN ORIGINAL MARK-UP EXCEEDS THAT REQUIRED

should be allowed to reduce the mark-up percentage.

Thus we see that some reductions have to be treated like additional mark-up cancellations even though, speaking technically, there have been no additional mark-ups; and we already have seen that some reductions that we have been treating as additional mark-up cancellations had better be treated as mark-downs even though they did actually offset additional mark-ups. It seems clear that the question "Should this reduction be allowed, or be not allowed, to reduce the percentage of mark-up?" should be answered not only by asking where the reduc-

Somewhat incidentally, it should be noted that some stores are avoiding the difficulty just described by bringing in merchandise bought speculatively at cost only and carrying it in a special reserve stock account at cost prices only until such time as the merchandise is needed on the selling floor. At that time the merchandise is transferred from the cost-basis reserve stock to the regular departmental stock ledger at actual cost and at the retail price which is then for the first time marked on the goods and which presumably is less likely to be influenced by the speculative enthusiasm felt at the time of purchase. This procedure introduces cer-

tain operating difficulties, but it achieves precisely the same end that is achieved by the practice of allowing cancellations of over-exuberant mark-ups to reduce the percentage of mark-up.

A similar situation arises when a buyer, in more or less normal times and not subject to any great speculative enthusiasm, makes a fortunate purchase, possibly by telling a resource that he is planning a special sale and would like to have a large quantity of merchandise at less than the usual price. If this merchandise, bought at less than the usual cost, is put in stock at the normal retail price, an unusually large rate of mark-up will be shown; and if then, after one or more month-ends have intervened, the contemplated special sale is held and prices lowered to a point below the normal retail price but to a point which, nevertheless, reflects about the normal mark-up, and if these reductions in price are treated as mark-downs, then the value of the closing inventory will be unnecessarily depreciated. This unnecessary depreciation can be avoided by applying the recommended procedure: namely treating all increases in price above the price of normal mark-up as mark-ups and by treating reductions above that price, when not due to physical deterioration, as mark-up cancellations.

So much for the first problem which has been given new emphasis by the rise in prices since April. The second problem reflects the desire of buyers and merchandise managers to control the recording of figures in such a way that their respective percentages of mark-downs will be as small as it is possible to make them.

Frequently, as wholesale and retail prices have gone up, buyers have found themselves with merchandise bought before the rise and marked at retail prices which now appear correspondingly low, but which they can increase in price because competitors, forced to buy at more recent and higher wholesale prices, have marked up their retail prices.

Under such conditions some buyers and merchandise men reason that the mark-up in price which they are able to take is due to conditions entirely beyond the control of the store (a statement which is not entirely true, but which has some element of truth) and that, therefore, there is no reason why the mark-up should not be offset against mark-downs. Such people propose: (a) to mark up the retail price; (b) to hold these additional mark-ups on "memo"; and (c) to offset later mark-downs against these mark-ups. This procedure is illogical and unwarranted on two counts. In the first place, it destroys the accuracy of the performance record by writing down the amount of mark-downs taken because of physical deterioration, obsolescence of style, or improper selection of goods; and in the second place, it tends to defeat the chief objective of the retail method of inventory, accurate cost-basis value of the inventory.

The proposal does this second thing because, by not allowing an increase in price to increase the mark-up rate, it permits a mark-up rate which reduces the closing inventory to a market-price basis, even though that price is higher than cost.

The suggestion that the mark-up reflects conditions beyond the control of the store is entirely irrelevant.

By way of summary, three points may be made.

1. The problems which department store controllers have encountered in administering the retail method of inventory since 1929 have disclosed no fundamental weaknesses in the method as developed more than ten years ago.

2. The problems which have come up have been caused not so much by the direct influences of the depression or of price changes as by the unusual managerial pressure on buyers and merchandise executives. This pressure seems to have led buyers and merchandising executives to make somewhat more than the usual attempts at the manipulation of figures, especially those for mark-downs, but there is no evidence that the vigilance of controllers has been relaxed or that they have been less successful than usual in preventing this manipulation.

3. Out of the discussion of the problems raised by the depression comes the recommendation that three changes be made in

the procedure under the retail method. It is recommended that: (a) mark-up cancellations (reductions which reduce the mark-up percentage) be permitted only above the price representing cost plus normally required mark-up and only when the reduction reflects no deterioration in the quality of the particular goods in question, no obsolescence in their style, and no maladjustment of these goods to local demand; (b) that all reductions reflecting deterioration, obsolescence, or maladjustment be treated as mark-downs (reductions which have no effect on the mark-up percentage); and (c) that all increases in price below the price representing cost plus normally required mark-up be treated as mark-ups if they occur before normal mark-up has been taken, but that they be treated as mark-down cancellations if they occur after normal mark-up has been taken.

The operation of the retail method with these changes is shown graphically in Chart 8 which indicates the greater depreciation of cost-basis values arrived at where physical or style deterioration occurs. It may be noted that the solid portions of the columns in this chart represent the operation of the orthodox method as well.

The chart shows plainly how changes in price which are allowed to affect the mark-up percentage (those which occur above the level of original retail price under the orthodox procedure; and those which occur above the level of normal mark-up, or before maximum retail price is reached, and which reflect market price movements only, under the recommended procedure) expand or contract the mark-up percentage and thus result in final cost-basis values reflecting actual cost price levels or market price levels, whichever are lower.

With these changes in procedure, the retail method will operate with greater accuracy and it will be protected against manipulation at several points.


CHART 8. RELATION OF COST, COST-BASIS, AND RETAIL PRICES GIVING EFFECT TO RECOMMENDED CHANGES IN METHOD (ASSUMED REQUIRED MARK-UP: 40%)

# PROBLEMS IN DETERMINING TOTAL COSTS OF DISTRIBUTION

WILFORD L. WHITE

INTEREST IN total costs of distribution has been stimulated for some time by the accusation that billions of dollars are wasted annually through inefficient distribution.[1] Recently, citizens have been told that distribution costs are too high.[2] Moreover, claims and counter claims have been made for the relative efficiency of different channels of distribution. Possibly of more significance at the moment, however, is the attempt of the federal government to analyze the consumer's dollar in order to determine how much the consumer pays, in the form of retail prices, and how much the producer receives. Only in this manner can the governmental departments know what the processors and distributors keep for their expenses and profits.

It is not the purpose of this paper to discuss a functional comparison of costs within one institution, such as a wholesale grocery house. Neither is any attempt made to compare the costs between two or more institutions operating at the same level in a particular trade; for example, clothing chains. Because of the limitation of time, neither will it be possible to do much more than point out the objectives, methods, and problems connected with total distribution cost analysis. The solution will have to wait upon the further study and experimentation of accountants and marketing men.

## OBJECTIVES OF SUCH A STUDY

Distribution costs, as a study, might be approached with at least three different purposes in mind.

First, A breakdown of distribution costs by different

(a) Channels of distribution, or
(b) Marketing functions, or
(c) Fields or trades

Second, A comparison of distribution with other costs, such as

(a) Total costs,—represented by the consumer's dollar—or
(b) Manufacturing or processing costs, or
(c) Costs of the original producer: that is, returns to the farmer, fisherman, miner, forester

Third, Relative costs of distribution under a capitalistic, socialistic, or communistic state.

## METHODS OF DETERMINING DISTRIBUTION COSTS

Before taking up the methods used in determining distribution costs, either *en toto* or as breakdowns, it seems wise to present, practically without discussion, six problems which are common to all.

## COMMON PROBLEMS

*First, what are distribution costs?* If one turns to the economist, the cost accountant, the management expert, and the marketing instructor, he will find four different answers. In fact, it is with difficulty that two accountants or two marketing men agree in detail, if published material and discussions may be used as a basis for a conclusion.[3]

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[1] *Nation's Business*: "The Shameful Waste in Business," by Julius Klein, May, 1928. Pp. 43 ff.

[2] *Advertising and Selling*: "Why and How Distribution Costs Must be Cut," by Dr. Mordecai Ezekiel, Sept. 28, 1933, pp. 23 ff.

[3] Converse writes: "Marketing in a broad sense covers those business activities which have to do with the creation of place and time utilities." *Elements of Marketing*, Prentice-Hall, New York, 1930, page 3. Pyle, on the other hand, writes: "Marketing may be thought of as that phase of business activity through which human wants are satisfied by the exchange of goods and services, on the one hand, for some valuable consideration—usually money or its equivalent—on the other." *Marketing Principles*, McGraw-Hill Book Company, New York, 1931, page 3. A committee of the National Association of Teachers of Marketing and Advertising recently defined marketing, used synonymously with distribution, as including "Those business activities involved in the flow of goods and services from production to consumption." N.A.T.M.A.—Bulletin, Report of the Committee on Definitions, National Association of Teachers of Marketing and Advertising, New York City, 1933 Series, No. 4.

The economist does not use the word distribution in the sense here concerned.

J. Ross Smith, general factory accountant for Western Electric, classifies distribution expenses as follows in a recent issue of the N.A.C.A. Bulletin:[4]

(1) Selling expense
(2) Advertising expense
(3) Warehousing (including storage, packing, and delivery)
(4) Financial and accounting (includes billing, credits, collections, and accounting pertaining to distribution as contrasted with production)
(5) Administrative expenses not provided for in the cost of manufacture.[5]

A management authority, however, in Management's Handbook (page 1250), suggests the following organization of the sales division of a manufacturing company: Advertising, Selling force, and Service.

Possibly the most widely used list of functions advanced by marketing men follows: Selling, buying, transporting, storage, standardization, financing, and risk-taking.[6]

A very practical classification by marketing men, originally prepared to determine the distribution costs of manufacturers in the grocery trade, is as follows:

1. Sales force and brokerage
2. Sales promotion and advertising
3. Shipping, warehousing, and delivering
4. Credit and collection
5. Marketing administration.[7]

[4] N.A.C.A. Bulletin, Section 1, September 1, 1933, page 38.

[5] According to the 1932 edition of the *Accountant's Handbook* (page 1333) the "distribution process" is divided as follows:
(1) Creating demand, that is, advertising, sales promotion and solicitation
(2) Obtaining orders, the meeting of minds, salesmanship
(3) Handling and delivery, physical operations incident to storage, sorting, grading, packing, loading, shipping, transporting, and delivering
(4) Realizing on the sale, arranging credit terms, billing, posting, preparing statements, collecting, handling, and depositing cash.

In the *Handbook of Business Administration*, (page 252) a similar list is present to which is added such items as estimating, service, and correspondents. . . .

[6] Clark, Fred E.: *Principles of Marketing*, Revised Ed., The Macmillan Co., New York, 1932, p. 13.

[7] Bureau of Business Research, Harvard University Bulletin No. 77; Marketing Expenses of Grocery Manufacturers for 1927, p. 5.

In general, there is some uniformity among these classifications, particularly between the last one and that reported by J. Ross Smith, but different approaches suggest different conclusions which would have to be ironed out or accepted, and generalizations would have to be converted into specific accounts before any significant studies can be made of total distribution costs.

*Second, whose costs are distribution costs?* To a few students of distribution, costs are confined to those incurred by institutions commonly considered as distributors, such as wholesalers and retailers. A larger group realizes that the final processor entails costs which are chargeable to distribution just as much as those of wholesalers or retailers.

Many people fail to realize, moreover, that distribution costs, such as those for transportation, storage, financing, and selling, are incurred long before a product is ready for final processing. A number of the best known marketing institutions handle raw materials and semi-processed goods prior to final manufacture. For example, in the pioneer study of the Joint Commission of Agricultural Inquiry, excellent breakdowns are presented for several products including corn flakes, for the years 1913, 1916, and 1921. The statement is made, "That it should cost approximately an average of sixty-three cents of the consumer's dollar to distribute thirty-seven cents' worth of corn flakes, indicates a very definite need of an improvement in the processes of distribution."[8] A study of the accompanying bar charts, however, discloses the fact that distribution costs start with the selling costs of the manufacturer and do not include an additional seven cents, classified as elevator margin and transportation from the producer through the elevator to the manufacturer. Total distribution cost cannot be determined until all such distributors and all such costs are accounted for.

*Third, can distribution costs be separated from processing costs?* A retailer, in the form of a department store or chain, may process

[8] Report of the Joint Commission of Agricultural Inquiry. Part IV, Marketing and Distribution, Government Printing Office, Washington, D. C., 1922, p. 210.

some products, such as women's coats, men's suits, coffee, bread. In such instances, processing costs usually are not shown separately in easily available form. Somewhat more important, however, is the manufacturing wholesaler who processes and distributes. His figures are seldom presented, broken down on this basis.

Most important, however, are the figures for the manufacturer who processes and distributes. Not only is there a difference of opinion concerning the point at which handling charges shift from processing to distribution costs, but many individual firms make little effort to segregate distribution and processing costs. Such sources as Poor's and Moody's offer very little help, and even recourse to the records of individual companies would be of little help unless use is made of some stardard report form. As early as 1920, the Federal Trade Commission developed and published a set of standard accounts for retailers but little was accomplished.[9] More recently some trade associations, among which is the National Retail Dry Goods Association, have attempted standardization of accounts within their trade.[10]

*Fourth, is interest on owned capital a distribution cost?* Authorities are divided. The Harvard Bureau of Business Research used to include "total interest" as an expense; at the present time it commonly shows interest handled in both ways.[11] The Retail Section of the Census of Distribution and the Federal Trade Commission, in its Chain Store Inquiry and other reports, include interest on money borrowed as an expense but exclude interest charges on invested capital.[12] For the purpose of such a study as is now under consideration, however, the question must be so considered from the point of view of comparability. In any comparison involving the cost of money, accuracy would not be obtained so long as interest on capital-owned was excluded and interest on borrowed capital was included. The same holds true for proprietors' salaries, particularly for retail establishments. The importance of this factor, however, is minimized by the following one.

*Fifth, are net profits a distribution cost?* Part of the net profits of processing institutions which do some of their own distributing and all, or practically all, of the net profits earned by distribution organizations are part of the economic costs of distribution although they cannot be called out-of-pocket costs or expenses of individual companies. On the assumption that net profits, after interest on capital owned as well as borrowed is deducted, are the result of successfully assuming the risks of management and are a return for managing skill, they can be called distribution costs, from the points of view of both the immediate customer and the ultimate consumer. A further discussion of this point is beyond the scope of this paper.

*Sixth, are all data reported for the same period?* Because so little information is available for a given trade, it is practically impossible in most instances to use data covering identical periods of time. It, therefore, becomes necessary to build up a case from the material available; at least to point out the difference in time; as was done in the Harvard grocery study.[13]

### THREE METHODS

*First Method:* The first of the three methods in use might be called, percentage base. It usually consists in taking the consumer's dollar or the retail selling price as 100 per cent and reducing all the figures under consideration to this base, adding them together, and thus determining the per cent of the ultimate dollar chargeable to distribution.

Certain problems, in addition to those al-

[9] A System of Accounts for Retail Merchants, Federal Trade Commission, Washington, D.C., 1920. Fundamentals of a Cost System for Manufacturers issued in 1916.

[10] *A Standard Method of Accounting for Retail Stores*, Controllers' Congress of the National Retail Dry Goods Association, Volumes I and II, New York City.

[11] Compare Bulletins No. 41 (Operating Expenses in Retail Grocery Stores in 1923) and No. 84 (Expenses and Profits in the Chain Grocery Business in 1929).

[12] See Retail Distribution Summary for the United States, Bureau of Census, p. 39 and Sales, Costs, and Profits of Retail Chains, Chain Store Inquiry, Federal Trade Commission, p. 4.

[13] Bureau of Business Research, Bulletin No. 84; "Expenses and Profits in the Chain Grocery Business in 1929." Pp. 14–21.

ready suggested, immediately present themselves, however. In the first place, are all percentages figured on the same base? Expense figures for wholesalers and retailers, for example, cannot be added together, since 100 per cent in the first instance equals, shall we say, 80 per cent of the figure used in the second. All figures must be reduced to a common denominator usually the retail selling price or the consumer's dollar.

Second, does all merchandise of the same class flow from producer to consumer through identical channels? If not, what alternatives are there, what proportion of the goods flows through each, and what is the proportion of the retail price absorbed?

More important, possibly, in the third place, to what extent are the percentages based upon a complete or a partial sample? Expense percentages for retailers and wholesalers, except for local studies, invariably have been given for samples only, with all the problems of sampling to be considered. This problem is intensified when different samples for different years are combined to secure a representative figure for a series of institutions distributing goods.[14]

The bulk of the studies following this method limit themselves to one institution and thus avoid many of these problems.[15] Engle, however, in an article to be published in the January issue of the Harvard Business Review, presents combined figures for the independent wholesaler-retailer channel, the chain system, and the manufacturers' wholesale branch-retailer method. The Harvard Bureau of Business Research, in its Bulletin No. 84, made a comparative study of grocery chains and independent wholesalers and retailers. In 1925, Niles and Niles, Certified Public Accountants of New York, issued a valuable bulletin which contains data on 15 classes of merchandise. In this instance the main breakdown is between producer's (or manufacturer's) costs and distributor's (or costs incurred by wholesalers and retailers).[16]

*Second Method:* The second method, consists in presenting total distribution costs in dollars by adding together the dollar distribution costs of business houses which have reported such data. Such a method was used in the 1930 Census of Distribution for the year 1929. Agents called upon all wholesalers and retailers, collecting statistical and accounting information, which was broken down into a few elementary divisions.

The student who follows this method is also faced with several problems in addition to those common to the other two. For example, since he is not using a sample but the whole, he must first define the trade or field in which he is working. It is one thing to secure a sample from the drug or hardware trade but it is quite another problem when every distributor of drugs or hardware must be accounted for, either in or outside the field. One common procedure is to include those whose sales of drugs or hardware, as defined by the business houses themselves, is over 50 per cent of the total, on the theory that the law of averages will work, leaving little if any error in the results.[17]

Second, any field is constantly gaining and losing business to closely and loosely related trades. A drug manufacturer sells to wholesale grocery houses. A wholesale hardware dealer solicits some cheap watch business from retail jewelers. Tire manufacturers call upon department stores and wholesale grocers sell to druggists. The distribution costs of drug manufacturers may cover a larger or smaller volume of merchandise than those reported in the aggregate for drug wholesalers or retailers. The total volume of dollar sales at one level, therefore, does not neces-

[14] One of the main criticisms of the Harvard grocery study, already referred to, in the paper or report issued by the National American Wholesale Grocers Association, and prepared by a member of Foreign and Domestic Commerce at Washington, concerns this point.

[15] Such studies are commonly prepared by University bureaus of business research and trade associations. Two rather recent studies are: An Analysis of the Distribution Costs (1931) of 312 Manufacturers, by the Association of National Advertisers, New York, and Trends in Ice Cream Costs (1927–1931 inclusive), International Association of Ice Cream Manufacturers, Harrisburg, Pa.

[16] Review of Published Statistics Relative to Cost of Merchandise Distribution, Rates of Merchandise Turnover, and Fluctuations in Manufacturing Employments in the United States, 1913–1923.

[17] Wholesales Distribution-Definitions and Classifications, Bureau of the Census, 1931, page 4.

sarily represent the same quantity, as the total sales at another.

A comparable situation is found in the third place, in imports and exports of the finished products of one trade. Manufacturers and wholesale distributors[18] tend to export while much of the importing is done by a similar type of wholesaler or larger retailers.

Fourth, sources included in the recent Federal Census of Distribution study, the first complete one of this type conducted in this country, did not segregate the costs of those agencies which performed the transportation function, such as freight and express charges of railroads, interurban lines, busses, and airplanes. Such information is not readily available either for entire trades or individual products.

Of course, it is true that some distribution functions, primarily transportation and storage, are performed by the producer on the one hand and the ultimate consumer on the other. Not only because the total cost of such items would presumably be small but because of the impossibility of determining their size by any method short of a guess, they should be given no consideration in this type of study.

Finally, the cost of collecting data on such a large scale is practically prohibitive except for a federal government. With over 147,000[19] manufacturing, 169,000[20] wholesaling, and 1,543,000[21] retailing establishments accounted for in the 1930 Census of Manufactures and Distribution, no one with less authority and less financial resources than the federal government should attempt such a study.

*Third Method:* The third method is limited to an analysis of an individual class of products.[22] More similar to the first method, it consists, by means of samples, of determining the retail price for the product under study and then, in breaking up that sum, according to the use to which it has been put. The earliest study on total distribution known to the writer, was of this type and was published in 1922 by the Joint Commission of Agricultural Inquiry. In this instance, moreover, distribution and processing costs were separated.[23] The main objective was to determine the proportion of the retail price which was received by the farmer for such products as bread, rolled oats, fresh beef, men's shoes, men's suits, and oranges.

Today the Consumers' Counsel of the Agricultural Adjustment Administration is using this same method primarily for the same purpose. At the time this paper was under preparation, the methodology was fairly simple, as explained by F. V. Waugh, a senior agricultural economist with the Bureau of Agricultural Economics. First, for products which are not processed, with the aid of the Bureau of Labor Statistics, the Bureau of Agricultural Economics secures a sample of retail prices in different cities for selected products. It then samples prices paid farmers for these products, by means of its own organization. Second, for agricultural products which are processed, a formula is attempted with the idea of determining the amount of raw material which goes into 100 pounds of pork sold at retail, for example, or a one-pound loaf of white bread.

Some of the problems peculiar to this method of procedure follow: First, the results apply to only one specific product and not to an entire trade. It is impossible to generalize for an entire field without working out in-

[18] According to the Bureau of the Census, export and import agents and commission houses are classified as wholesale distributors.

[19] Distribution of Sales of Manufacturing Plants—Fifteenth Census of the United States—United States Department of Commerce—Bureau of Census, page 1.

[20] Wholesale Distribution—Fifteenth Census of the United States—United States Department of Commerce—Bureau of Census, p. 69, table 1.

[21] Retail Distribution—Fifteenth Census of the United States—Department of Commerce—Bureau of the Census, page 45, table 1A.

[22] Dr. L. D. H. Weld discusses the first two of these three methods of determining total distribution costs in a paper read before the Taylor Society but makes no mention of the third one. Bulletin of the Taylor Society, April, 1933, pages 26 ff.

[23] In two later analyses of the Bureau of Agricultural Economics (Department of Agriculture) on cotton cloth and bread, issued in 1923 and 1924, processing and distribution costs were not separated. Analysis of the difference between the Retail Price of Cotton Cloth and the Price of Cotton, and An Analysis of the Retail Price of Bread in Seven Cities; October 1922 to March 1923, inclusive.

dependently, information for each product distributed, a method which would be prohibited by time and cost.

A more important weakness of this method is that the same product is distributed through a number of different channels and with varying sales methods. That is, eggs, for example, may be sold to the ultimate consumer by the producer at wayside stands, by mail, in a city market, or at the consumer's home. More commonly, however, they reach this consumer *via* one or more middlemen including some type of retailer.

In determining what the retail price is, at a moment of time and for a particular product in a specified market, it is necessary first to price eggs which have reached that market by all of the varying channels and second, to weight each price according to the volume which moved by each channel. In order to calculate the average price received by the farmer, it is not only necessary to learn by which method he sold his eggs, but to weight each method according to the volume distributed in that manner. Such refinements can be carried too far, but without recognition of them, ignorance might permit errors which would nullify the value of the results. As long as the sample method is used, incorrect results may arise from improper weighting. The moment information is requested or required from all distributors, the cost in time and money once more becomes almost prohibitive.

Next, joint costs complicate the accurate determination of costs under this system. Of little concern where there is little processing, this point becomes of major importance where these costs run relatively high. Unfortunately, for the purposes of such a study, many products other than white bread are manufactured from wheat. Whether the student starts with wheat at one end or white bread at the other, there are a number of costs, distribution and processing, which are common to a variety of items. To do anything more than to separate the producers' share from all other costs involves a study of joint costs, at least by the processor, a method which is yet young and inexact, as applied to distribution. The problem is even more complicated in the case of cattle and meat or cotton or wool and clothing.

Finally, while both of the other methods involve a year or some considerable period of time, this one may not concern more than one day or week. Farm and retail prices for such a short period may not be typical at all for a particular product. To collect such data for six months or a season would again be very expensive and would probably make such an approach impractical, even for governmental use.

### SUMMARY OF PRESENT SITUATION

It is obviously impossible to determine exactly, total distribution costs, even for one product. At the present time, the most exacting method is the second, or the use of total dollar costs. For this purpose, however, the 1930 Census of Manufactures and of Distribution will not furnish all the information. Institutions which manufacture and distribute did not report these costs separately. The 1933 Census of Manufacturers may produce some data on this point. In addition, certain marketing organizations were not called upon at all to report their figures.

The other two methods are based upon samples and in the practical taking and using of samples, many errors creep into the computations. More data are available, actually and potentially, for the calculation by the first of these two, or percentage base. Such statistical information has been and can be gathered piecemeal by different research agencies at different times. Herein, however, lies one of its main weaknesses.

The third method is without doubt the best of the three when time is at a premium, provided a rough estimate is sufficient. Any practical sample, however, is so small in the light of all possible variables that the results should not be alone accepted as final.

### FUTURE STUDIES

Before accurate and valuable distribution cost figures are available for study, certain conditions must exist. Stated absolutely, manufacturers and distributors first must use a common and coördinated system of ac-

counts. Second, they must handle their accounts in a similar manner. Third, their records must be open for purposes of a statistical investigation. Fourth, some agency, presumably the federal government, must have the power to secure the necessary information from these books and have the funds and personnel necessary to work up the material promptly and completely.

With such a situation, the second method, that of determining the total dollar distribution cost would be the most practical. With these data at hand, percentage breakdowns would be available for institutions on different levels or of different types. Similarly, costs for many individual products could be secured from the same records, on the assumption that uniform accounts and uniform methods of treating them would make available comparable data for individual products as well as for an entire business.

DISCUSSION BY PROFESSOR E. J. FILBEY

The problems that are faced by the statistician who attempts to determine the costs of distribution have been set forth so clearly by Dr. White in his paper that I feel that he has left me little opportunity to contribute anything of value to the discussion. We must agree that all the problems that he mentioned do exist, and that each of the three methods described are open to the objections cited. I shall therefore limit my remarks to a few comments upon some of the difficulties referred to by Dr. White, without, however, proposing to offer a complete or satisfactory solution to these difficulties.

In order to be able to arrive at a correct determination of distribution costs it is evident (1) that there must be available as many pertinent facts as can be ascertained, and (2) that the number of assumptions which we are obliged to make must be reduced to a minimum. The facts with which we are to deal must have been recorded with accuracy and in detail. If the regular bookkeeping records do not contain all the information needed, it will frequently be necessary to go beyond these, if the original details can be found only in the less formal records of a concern. Again, the degree of accuracy and the soundness of any conclusions we may reach will depend in large measure upon the relative proportion of direct costs, semi-direct costs, and indirect costs, with which we are obliged to deal.

Although, as Dr. White has suggested, the economist, the cost accountant, the management expert, and the marketing instructor differ in their answers to the question, "What are distribution costs?", the differences in the conceptions of these various experts are not serious or irreconcilable, except perhaps in the case of the economist. And in the five classifications of distribution expenses cited by Dr. White, we find no great dissimilarity. The first and the last are substantially identical. The others represent either a slightly greater analysis of the fundamental groups, or a different combination of closely allied activities. Dr. White's conclusion correctly gives the answer to this first problem.

In attempting to answer the second question, "Whose costs are distribution costs?", we shall be obliged, as Dr. Whites intimates, to come to an agreement as to the particular stages we wish to include in a study before our final results will be comparable or even interpretable. And this means, of course, before the results will be of *value*, for it may be assumed that we are concerned not primarily with a search after truth in the abstract, but after facts from which conclusions can be deduced for the betterment of business procedure, and for the welfare of society.

"Can distribution costs be separated from processing costs?" They can, of course, be separated by the analyst only if the individual concerns have kept their records in such detail that the facts are available. If the various trade groups can be persuaded that the results of statistical studies of their costs will be of value to their individual members, it should be possible to secure their coöperation in the keeping of such records as will furnish the detailed data required.

"Is interest on owned capital a distribution cost?" Authorities, as Dr. White says, are of course divided. Personally, I have gradually changed sides on this question,

and am now inclined to answer it in the negative. For a failure to earn a possible income does not constitute a true cost; and in the case of most other costs, when the cost is charged with a given amount, a liability or an asset or a reserve is credited. In the case of interest on investment, some income account such as Interest Earned on Investment must be credited; and thus, in effect, the debit is no sooner recorded as an expense than it is cancelled. However, it must be admitted that distribution costs cannot be compared in detail on precisely the same basis unless interest on capital is treated in substantially the same manner as interest actually paid on indebtedness to outsiders. Inasmuch as there is little hope that a uniform procedure will ever be adopted in this matter, there will always be a certain amount of unavoidable variation in any series of comparisons made in which the cost of money is involved.

I agree with Dr. White that for practical purposes, his fifth question, "Are net profits a distribution cost?", is to be answered in the affirmative so far as the consumer is concerned. On the other hand, profits are not, of course, an element of the distributor's own total cost.

It is to be hoped that such progress in distribution cost accounting will be made in the immediate future that it will before long be possible to secure data covering identical periods of time, in the case of many lines of industry. As has already been intimated, it is practically a matter of convincing business leaders that the results to be obtained from the study of detailed records of distribution costs will be of sufficient value to justify them in incurring the expense necessary to collect and record currently the essential facts.

As to the first of the three methods described by Dr. White, I will only refer again to a statement that I made in connection with one of the problems he mentioned, namely, that we cannot, of course, combine unlike units, or discuss unlike combinations of units, and arrive at logical results. If, however, similar facts have been recorded in detail, and the detailed information is available, the statistician should hope to be able to draw conclusions that would prove unassailable.

As to the second method mentioned, that of assembling the dollar distribution costs of all business houses that have reported, I agree exactly with Dr. White as to the several difficulties to be encountered. On the whole, however, I believe that although the various disturbing factors will very considerably affect the accuracy of the results, they will not by any means render them valueless. To the difficulties enumerated by Dr. White I will add another, namely, that a given commodity sold by the retailer in one year may not represent the same commodity that was reported by the wholesaler as sold in that year, as the retailer may have made his purchase in a prior period. The statistician will therefore be dealing with two different lots of merchandise.

The difficulties encountered in the analysis of an individual class of products, the third method discussed, have been very well set forth by Dr. White. In brief, it may be said that although certain definite conclusions can be reached in regard to individual commodities, few generalizations can logically be attempted with these separate (and often unrelated results as a basis.

Finally, I am in complete agreement with Dr. White as to the conditions that must exist before conclusions regarding distribution costs can be stated with accuracy and with confidence. We must have accounting records that are detailed, complete and accurate. Uniform accounting systems will have to be adopted by each industry, as has been done, e.g., by the National Canners Association. It must be possible, by persuasion or by statute, to ascertain from business records the pertinent facts relating to distribution costs. And if it can be demonstrated that the results to be achieved will sufficiently benefit the general public to justify the expense involved, the work should quite certainly, as Dr. White maintains, be performed by the Federal Government, except in the case of those industries that are willing to carry out these studies through their national trade organizations.

EDWARD J. FILBEY

# THE MANUFACTURER LOOKS AT HIS COST OF DISTRIBUTION

Paul W. Atwood

It has been said that during the past fifty years the cost of manufacturing in the United States has been reduced by more than 20 per cent while, during the same period, the cost of selling and distributing goods into the hands of the consumer has been increased by more than 300 per cent. It has been said, also, that the total cost of distribution at the present time is equivalent to approximately one-third of our entire national income.

Whether these statements accurately reflect conditions or not, it is generally recognized, nevertheless, that while intensive efforts have been made for many years to reduce costs in the production end of business, and with a marked degree of success, distribution costs, on the other hand, have more recently come under the scrutiny of executive management.

Distribution costs involve the total cost of carrying goods from producer to consumer—the costs of operating retail stores, the costs of operating wholesale houses, transportation costs and the manufacturer's selling costs. My remarks today are concerned chiefly with the cost of distribution from the standpoint of the manufacturer.

When the individual manufacturer sets out to find ways and means of reducing his distribution expense, one of the first questions that comes to his mind is how do his costs compare with those of other manufacturers in his industry selling the same or a similar type of product. And it was in an attempt to aid in answering this question that the Association of National Advertisers undertook a few months ago to assemble distribution cost figures from representative manufacturers in leading industries of the country. It was hoped that we could provide a yardstick by which each individual manufacturer could determine whether or not his own costs of distribution were in line with those of his competitors.

For the benefit of those of you who may not be thoroughly familiar with the aims and purposes of the Association of National Advertisers, I think I should say that we are working toward greater effectiveness and economy in advertising and selling. Our membership is made up entirely of buyers of advertising, some 300 in number, most of which are manufacturers.

Newspapers, magazines, advertising agencies and other organizations whose income is derived *from* advertising are not admitted to membership. I mention this so that you will understand that the association is distinctly not interested in increasing the volume of advertising but rather in eliminating wastes and securing greater effectiveness for every dollar spent in advertising.

Our aim is to find ways and means for the manufacturer to sell goods as economically as possible. That is why A.N.A. members are concerned with the cost of selling and distributing goods.

In undertaking this survey we invited the National Association of Cost Accountants to participate with us, since the desired information was directly concerned with cost accounting. The first step in our program was, of course, a preliminary investigation to find out what material was available on the subject. Our investigation revealed that while numerous studies had been made by various organizations on selling and operating costs in both the wholesale and retail fields, relatively little information was available on manufacturers' costs of distribution. Furthermore, we found that the few surveys of manufacturers' costs which had been made were confined in most cases to some one particular industry. For example, a study of marketing expenses of grocery manufacturers was made for the years 1927 and 1928 by the Harvard Business School and a study of distribution cost problems of manufacturing confectioners in 1931 by the De-

partment of Commerce in coöperation with the National Confectioners Association.

Those of you who are familiar with the subject know what a variety of selling methods different manufacturers employ. Some companies sell direct to the consumer through house-to-house distributors or through the mail order business. Many companies sell entirely through wholesalers and others sell entirely through retailers. The majority of companies, perhaps, sell in combination of two or more of these methods so that tremendous difficulties are presented in securing comparative figures that are of real practical value.

In our survey we divided distribution costs into seven major classifications, as follows: (1) direct selling costs which included salesmen's compensation, travelling expenses, sales office expenses, etc. (2) expenditures for advertising and sales promotion, (3) transportation charges, (4) warehousing and storage charges, (5) credit and collection expenses, (6) financial expenses and (7) general administrative expenses prorated to distribution.

Detailed information was secured by the active coöperation of 312 manufacturers, with an aggregate annual sales volume in excess of one billion dollars. The data covered the years 1931 and 1932. All figures on costs were reported on a percentage basis, representing the relation of each cost item to the total net sales volume. The net sales figure was determined by deducting from gross sales returned goods and allowances to customers including trade discounts. Averages were compiled for 29 different industries, 19 of which were designated as Consumer Products including such items as food, clothing, and household furnishings and the other 10, Industrial Products or Producer's Goods such as heavy machinery, building materials, etc.

While it is of course impossible in a brief space of time to tell you very much about the statistical results of the survey, I would like to give you a few figures which may be considered more or less representative of the analysis as a whole.

Total costs of distribution in relation to net sales, as compiled in our report for the year 1931, ranged from an average of 38.8% for manufacturers of drugs and toilet articles down to 9.15% for textile manufacturers. Petroleum products averaged 31.04%, jewelry and silverware 28.66%, grocery products 27.11%, household appliances 26.45%, clothing 22.63%, shoes 21.19%, transportation equipment 15.5%, etc.

In dividing total distribution costs into the different cost items, we found that in direct selling costs, which included salesmen's compensation, travelling expenses and sales office expenses, the office equipment group ranked highest with an average of 21.26%. Paints and varnishes came next, averaging 17.11%, heavy machinery 14.61%, grocery products 11.54% and agricultural equipment 8.24%. Tobacco products averaged 3.23%, the lowest of any group.

From these figures you will appreciate the wide variation in costs which were found to exist between the different industries. It is not my purpose to explain why any particular industry showed a higher or lower rate than another. However, it may be of interest to point out that in the office equipment industry, which shows the highest rate of any industry in the relation of direct selling costs to net sales, a great deal of time and effort is required, ordinarily, on the part of a salesman to complete a sale, whereas, in the tobacco industry the work of the manufacturers' salesman consists largely of following up the jobbers' salesman in order to make sure that the company's products are getting their share of the promotional efforts, and therefore, his expense is lower in relation to the total business accomplished.

Expenditures for advertising and sales promotion, in particular showed a wide variation not only between different industries but also between different companies within the same industry. An analysis of the automotive accessory field, for example, revealed that manufacturers of specialty products usually have larger advertising appropriations in relation to net sales volume than manufacturers of the more staple products such as tires and storage batteries. In the drug field, which showed an average adver-

tising expenditure of 18.36% in relation to net sales, manufacturers of proprietary medicines reported much higher ratios than manufacturers of toilet preparations and cosmetics. Another report, issued by the association a few months ago, which was devoted exclusively to advertising budgets showed an average advertising expenditure of around 40% of net sales for proprietary medicines. One of these companies, incidentally, reported a figure of 60% of net sales volume spent in advertising which made up practically the entire distribution expense of that company. Of course this is an exceptional case. Nevertheless, it serves to illustrate the fact that specific merchandising problems may exist in some companies which call for higher or lower ratios in advertising, or in other distribution costs, than in other companies selling a similar type of product.

Tobacco products averaged 8.23% in advertising expenditures, grocery products 6.21%, radio equipment 5.33%, heavy machinery 4.38%, office equipment 3.23%, hardware 2.16% and chemical and allied products 1.22%. It is interesting to note that the office equipment group, which in direct selling costs showed the highest rate of any of the groups, is among the lowest in advertising expenditures, while tobacco products, which showed the lowest direct selling costs of any group, is second from the top in advertising.

In transportation costs, which included out-freight, cartage and express, long distance trucking, local delivery and in-freight paid on returned sales, manufacturers of grocery products, bottled beverages and agricultural equipment showed the highest ratio, averaging around 5% of net sales each. Eleven industries out of the 29 averaged 1% or less with jewelry and silverware manufacturers on the bottom with .31%.

Warehousing and storage charges, which included total warehousing, storage and handling expenses on finished goods properly chargeable to distribution, ranged from 4.29% for petroleum products down to one-tenth of 1% for electrical equipment and supplies.

It is obvious that when goods are bulky, transportation costs and warehousing and storage charges are relatively high, while such costs are low for smaller articles of higher average value.

Credit and collection expenses, which included the costs of maintaining a collection department, legal fees and credit service together with losses from bad debts were highest for jewelry and silverware averaging 3.5%. This is a luxury item. In the majority of cases credit expenses ran less than 1%.

With most companies, financial expenses and general administrative expenses prorated to distribution were relatively small factors.

In every case figures were compiled according to the sales volume of the contributing companies. The results showed that in some industries, companies with the highest sales volume reported the lowest rate of total distribution expense to net sales while in other industries the opposite tendency seemed to prevail.

In comparing data for the two years covered in the survey we found that 40 per cent of the companies showed a higher ratio of total distribution expense to net sales in 1932 than in 1931, 53 per cent showed a lower ratio and 7 per cent showed approximately the same ratio. The greatest decreases were in direct selling costs, reflecting the general reduction in salaries and wages.

The National Industrial Conference Board took our figures as published in our report and compiled averages separately for all manufacturers of Consumer Products and all manufacturers of Industrial Products. For Consumer Products the results showed an average of 26.8 per cent in the relation of total distribution costs to net sales, 11.9 per cent of which made up direct selling costs, 6.1 per cent advertising and sales promotion and 8.8 per cent all other distribution costs. Manufacturers of Industrial Products averaged 20.6 per cent in the relation of total distribution costs to net sales. Direct selling costs accounted for 10.8 per cent of this, advertising and sales promotion 2.7 per cent and other costs 7.1 per cent.

As I indicated previously, this was a fact-

finding survey only and no attempt was made to explain the reason for the wide variation in costs, to determine the most economical method for the manufacturer to use in selling and distributing his goods or to arrive at any conclusions as to the proper ratio of distribution expense to sales volume for any industry or any particular company. Our aim was to present the facts as we found them.

By and large, the results of the study would seem to indicate that far reaching changes are taking place in the methods of distribution in many fields. Manufacturers are experimenting. They are concerned over the cost of distribution and are determined to find more economical ways of selling their goods—if such there be.

We know that many companies have already succeeded in bringing about substantial reductions in their distribution costs. Naturally, the methods that will aid one company may not fit the requirements of another. Some of the methods which have been used successfully by certain manufacturers—and this by no means completes the list—may be described briefly as follows:

1. A closer accounting of all costs of distribution.

2. The establishment of sales expense budgets, on the basis of sales volume budgets, by lines of products, by territories and by salesmen.

3. Closer attention to the selection and training of salesmen.

4. Greater coöperation with dealers.

5. The addition of other lines of products which can be sold together with the original lines without materially increasing sales and distribution expense.

6. A reduction in the number of lines carried eliminating those products which contribute a disproportionately small part of the total sales volume and fail to pay their own share of the distribution expense.

7. Application of the principles of Selective Distribution whereby unprofitable customers and territories are eliminated and greater concentration is placed on a selected list of outlets.

8. The development of new products or improvement of old ones.

9. A greater coördination of production and distribution.

10. Mergers of corporations which sometimes provide additional sales outlets or better balanced distribution facilities.

11. Decentralization of a manufacturing enterprise with local or regional production.

12. Entrance into the retail field, although past experience shows that considerable risk is involved in most cases unless such action is thoroughly analyzed in advance.

13. Closer correlation between personal sales efforts and advertising campaigns.

14. Sales and advertising research including tests of advertising mediums employed and type of copy used.

In connection with advertising research I would like to say that perhaps no subject is of more intense interest to members of the association at the present time than that of copy testing. Many different methods of pretesting the effectiveness of advertising have been used with varying success. None of these, however, seems to be the "ideal" method and the A.N.A. is at work at the present time, through the efforts of its Copy Testing Committee, endeavoring to find more practical means of testing the effectiveness of advertising copy and thereby placing advertising on a more scientific basis.

We hear a great deal in this New Deal Era about the excessive costs and "intolerable wastes" of advertising. It is certain, however, that the large corporations that spend huge sums in advertising each year do so because they have found, through experience that this is the cheapest method they have discovered so far of selling their products. And we can rest assured that they will continue to use this means until a more economical method is developed.

This leads me to an observation I should like to make in respect to advertising effectiveness. Since so little in the way of reliable facts is available, it is difficult to determine with any degree of accuracy this question of advertising effectiveness and perhaps that is the reason why criticism has developed, particularly during the depression period,

against advertising as being an economic waste. Advertising has been singled out more than any other factor perhaps as being the worst offender from the standpoint of contributing to the high cost of distribution.

While there is, no doubt, some ground on which to base such an accusation, and the A.N.A. is cognizant of this because one of its chief functions, as I have indicated, is to seek out and try to eliminate those wastes, nevertheless, there is another side which unschooled critics are prone to overlook or perhaps do not appreciate and it is this: by and large advertising tends to reduce the cost of distribution rather than to increase it, otherwise it could not continue to exist.

There is no better evidence in support of that statement, perhaps, than that furnished by Mr. Wroe Alderson, Assistant Chief of the Domestic Commerce Division of the Bureau of Foreign and Domestic Commerce. Mr. Alderson is one of the few government officials who has made a thorough study of advertising and its effect on the cost of distribution. Basing his conclusions not on personal opinions or beliefs but on actual facts assembled by the Department of Commerce in two comprehensive surveys, the Louisville Grocery Survey and the St. Louis Drug Store Survey, Mr. Alderson says:

> The manufacturer's advertising makes possible economies in wholesale and retail distribution which are in turn reflected in lower prices to the consumer. The consumer normally receives fifty cents in return for every five cents expended for drug and cosmetic advertising. The economies which advertising brings into distribution have to deal with minimizing the enormous cost of consumer indecision. These savings are manifested in the two directions of accelerated turnover and a reduction of the time required for each sales transaction. The turnover is from three to ten times as great on an advertised drug or cosmetic product as it is on a product presented to the consumer by other means. The time required by a sales transaction is typically only half as great on advertised as on non-advertised products. These are not merely theoretical savings but are reflected directly in the form of smaller mark-ups taken by the retailer and wholesaler. . . .
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> To those who feel that advertising is an unwarranted addition to the distribution spread on food and drug products it seems that a saving for the consumer could be achieved by obliging the manufacturer to forego advertising expenditure. . . . This plan would work out very well if the producer was in direct contact with the consumer. As a matter of fact, the manufacturer would find himself further away from the consumer than ever and would very quickly find himself involved in more expensive methods for reaching the consumer than advertising.

* * *

There is another important factor affecting the cost of distribution and which is virtually beyond the control of the manufacturer. I refer to the demand of the consumer for convenience of supply and for service in connection with his purchases. This is expressed by his willingness to pay for the costs of extending sales outlets throughout residential and suburban areas, maintaining efficient but expensive delivery services, and the like.

It would be interesting indeed if in some way we were able to determine how costs of distribution in many lines of merchandise might be reduced if the public would forego its demand for convenience of supply and for service and agree to go out of its way—say to a shopping center—as it does in the case of the so-called shopping items, and stock up with a supply beyond that required for immediate needs. I do not wish to imply that these conveniences should be taken away from the consumer. This is merely an observation in the light of criticisms we sometimes hear directed against manufacturers because of high costs of distribution, costs which are borne in the final analysis by the consuming public. The fact should not be overlooked that the public plays an important part in contributing to those costs, as I have tried to indicate.

It is evident that the future is going to see a closer scrutiny of all distribution expenses. Management has come to realize that sales volume and profits do not necessarily go hand in hand. If we have uneconomical methods in our distribution set-up there is reason to believe that this is due largely to the fact that so little has been known of what it costs to sell and distribute goods. It is gratifying to note an increased

interest in the cost factor in distribution as a result of the enactment of the National Industrial Recovery Act.

From the welcome accorded our survey of manufacturers' distribution costs, we believe it has been of much practical value. We know that it is causing many manufacturers to scrutinize their costs more carefully. For example, at the annual meeting of the National Association of Cost Accountants held in New York last June, representatives of two companies, Waitt & Bond, Inc., and the Briggs Manufacturing Company, presented papers analyzing the distribution costs of their respective companies on the basis of the information secured in our survey. We believe it has been of distinct aid in focusing the attention of executive management on distribution costs.

On the other hand, we recognize that the study is only a beginning—a start in the right direction. Very few manufacturers know what it costs to sell a specific product to a particular dealer. If the manufacturer can determine how much it costs to sell each article he makes and how much it costs to carry on business with each customer he serves, he will then have a basis for determining whether he can sell this article and service this customer with profit to himself.

But more is required than the individual efforts of manufacturers along these lines. It is a broad problem of industry which requires the wholehearted coöperation of all interests involved. The fact that manufacturers are willing to go to the expense and trouble of contributing what has usually been considered highly confidential information to a coöperative effort of determining the extent of these costs, such as the A.N.A. survey, is evidence that the subject is receiving the increasing attention which it deserves. And the interest of your group, as evidenced by your action in inviting me to appear before you, is indeed an encouraging sign that through continued research and the coöperative efforts of all of us, we may be able to assemble more facts and to interpret these facts so they can be properly and effectively applied.

# SOME ASPECTS OF STANDARD COSTS

JOHN BALCH

THE PRINCIPAL difficulty which confronts one in discussing Standard Costs is the fact that so many different interpretations have been brought forward with respect to methods and definitions. Almost every one who has indulged in the practice of installing "Standard Cost Methods" has some particular bookkeeping hobby or private terminology which to him is all important. The use of the word Standard itself is rather unfortunate in that to the average mind it connotes "model of perfection" whereas it is used largely as a base from which comparisons can be drawn.

For the purpose of discussion we will consider a Standard Cost to be the predetermined estimated cost of a given product including the three essentials of Material, Labor and Overhead and presuming the inclusion of all overhead, factory, general and sales.

There are many kinds of industry which readily lend themselves to the use of standards and some in which the use of standards is the only practical way by which cost accounting data can be assembled without increasing the cost of production to a prohibitive figure or delaying the production procedure by endless weighings, or counting. This has been recognized for many years and the practical accountant used formulas, or bills of material, or normal averages for years before the present publicity was so brilliantly focused on so-called "Standard Costs." It is unfortunate that our profession has used so much salesmanship and so little common sense in amplifying the possibilities of comparison which the use of Standards makes possible. This has often caused executives to throw out methods of accounting which had been acquired at considerable expense and which by their very complexity were often misunderstood and therefore not appreciated.

The installation of cost methods which will be successful in a given plant must first of all, irrespective of accounting theories, be designed for the use of the particular executives associated with the plant in question. Nine out of every ten unsuccessful installations of costing methods have overlooked the basic fact that to be successful, accounting records must be *used* and they often cannot be used by the very executives for whom they were designed, by reason of the characteristic or intellectual limitations of the respective executives. It is most exasperating to the practical mind when asking questions about costs or values to be told that a certain figure on a balance sheet, or on a cost sheet, must this month be adjusted by such and such a percentage, and that the variance of so much must be taken into account in arriving at the real figure, and that the use of a certain figure presupposes one adjustment for quantities and another adjustment for values. I have seen able executives consign reports to the waste basket many times with the disgusted remark that "they'd figure it out for themselves without any confounded adjustments." Of course on the other hand there are trained executives who can appreciate such statements and who will use complete standard comparisons throughout all departments and with respect to all the elements of cost. The emphasis, however, should not be put upon the perfection of theory when designing methods but rather on the possible *use* of the records, taking all things into account.

The larger and wealthier plants can often experiment with various accounting methods, whereas an average size plant may not be able to. It is indeed wise for the installing accountant to therefore keep always before him, the practical requirements of the plant in question. It would be an excellent accomplishment if every student of accountancy could be made to truly realize that the accounting work of any business is in no sense an end in itself but only a means to an end. The *use* of available data to improve execu-

tive judgment, to reduce losses, and to increase profits being the end which is desired.

In discussing *Standard Material Costs* we are confronted with two problems. Quantitative standards and value or price standards. In industries where the formula should be used, where weighing or counting is impractical, as for instance in the making of paper, or full fashioned hosiery, it is undoubtedly best to use quantitative standards. In other industries where the actual materials can be easily controlled from a physical standpoint, through stores issue or otherwise, it seems totally unnecessary to carry quantitative standards into the accounting procedure merely to account for variances from standard. Most manufacturers and men of practical mind want to have rock bottom facts presented in their books of account and on their cost sheets and therefore prefer to have actual quantities recorded in the books of account rather than theoretical quantities. This does not prevent the standard enthusiast from setting his standards and following up all variances therefrom promptly. But this follow up can be done just as effectively if the actual quantities are recorded in the books of account and no exhaustive explanations about adjustment accounts will then be needed.

In the matter of price or value standards for materials, it was easy to be enthusiastic when contracts could be placed for a year ahead and the world seemed fairly stable, but when values have undergone the tremendous changes in both rising and falling which have occurred recently, it is hardly worth while to set any standard at all. Standards really become quite ridiculous when the variances from standard amount to as much or more than the standard. If we constantly change standard prices, they are not standards, and if they are ridiculous they certainly should be discarded. Again the average practical executive wants facts not fancy, and it would seem far better to carry actual average values of material into the books of account. If it is necessary to have a measuring stick of the accomplishments of the purchasing department, it is quite possible to set up such a record outside of the books of general account. The foregoing remarks on Price Standards are equally applicable whether actual quantities are recorded in the subsidiary material ledgers or whether standard or formula quantities are recorded. It is assumed that subsidiary material ledgers are tied in with and are a part of the general books of account.

In discussing *Standard Labor Costs*, we are today in very much the same position with respect to changing values as we are in with respect to material values, except that the changes have not been quite so kaleidoscopic. It is undoubtedly very valuable especially where wage incentives can be applied, to have certain standards set up. Probably greater savings can be accomplished through such use of standards for studying labor than in any other particular field of activity in most industries, as labor is notoriously inclined to soldier if not closely checked. This does not necessarily mean, however, that the standard labor costs are the ones which should be carried into the books of account. It is entirely possible and sometimes very wise to set up standard labor costs for all the various operations in a plant. It is further, most advantageous to have a daily check against the standard, of all the actual labor costs of every operation. This type of engineering control may pay big dividends and can be accomplished just as successfully outside of the books of general account as it can be if tied up as a part of the accounting routine. We again come back to the probable use of our cost information by practical executives who want to know actual facts rather than theoretical performance plus or minus certain variations. In order to adequately use the variations from standard which arise from labor comparisons, we must report actual performance and evaluate it. Further we must use the evaluation of the actual performance in preparing the payroll. Since these values will be figured anyway it seems the part of wisdom to proceed in a straight line and use them in the books of account instead of proceeding to first ignore them and then eventually use them by way of variance accounts. Proponents of standard methods always lay great stress on the

fact that the actual values are really in the accounting record since the difference between standard and actual is always shown through a variance account. This causes one to wonder why the actual shouldn't be used in the first place and be done with it.

In the case of both Material and Labor it would seem that all the advantages of comparison with standards, could just as well be accomplished without cluttering up the inventories and books of account with more or less meaningless adjustments. Of course a good sales argument can be produced for inclusion in the records but should not our profession lean backwards if anything, in preparing for clients the kind of records which will be economical, practical, and the most easily used and understood, rather than the most expensive irrespective of possible features which yield readily to salesmanship?

Before discussing *Standard Overhead Costs* we should divide the overhead into two classes. First the Factory or Mill Overhead, and secondly the General Administrative and Sales Overhead. These are separated, as the first is usually included in inventories and eventually becomes a part of Cost of Goods Sold, whereas the second is seldom inventoried and is generally charged directly to the Profit and Loss account. Most of the items composing Factory or Mill Overhead are items which do not occur regularly and for this reason cannot be accounted for on an actual basis without causing serious discrepancies in overhead, applied to one period as against other periods. It is therefore advisable to predetermine what will be the normal overhead and to set up a Budget or Standard for all such items. Having established this type of standard or normal another step must be taken. The various items ascertained will not apply to all departments of a given plant. It is therefore necessary to set up departmental budgets or standards in which the fair applicable share of each predetermined overhead item will be allocated to some service department or productive department. In this way we can develop the most useful type of Factory Overhead Standard. By dividing such an overhead standard by the normal productive units of a given department a standard overhead rate is established which is a fair and equitable basis for applying the overhead to the product and for calculating the operating credits for the various departments. For the benefit of the practical executive we would again ascertain as closely as possible what the actual overhead in a given product should be, by applying the standard rate to the actual productive units chargeable to a given product. Where possible these units should be machine hours or man hours rather than pounds or other quantitative units. If desirable it is of course possible to figure a Standard Overhead Cost but such a cost is of necessity much further from the actual facts in the case and is therefore of relatively less value.

Whether Standard Overhead Rates are used or Standard Overhead Costs are used, the net difference between the overhead carried into inventory and the actual overhead will be carried to a variance account. Considerable advantage can be obtained by subdividing such a variance so that losses or gains attributable to Non Productivity, Excess Productivity, Excess Expenditures, Economy of Expenditure, Variable Overhead Expense and Controllable Overhead Expense can be analyzed and studied separately. Such studies are idle, however, unless actual use of the information is made promptly to correct unwise or wasteful practices.

The General Administrative and Sales Overhead will not usually be carried into the inventory records and must of necessity by its very nature be largely allocated to cost on arbitrary bases. It is therefore in the application of these items that Standard Costs are most practical and most useable. Such costs will be used principally for estimating Selling Prices and for developing various policies and the arbitrary average or Standard Cost will therefore be needed since policies, affecting the future must of necessity be based on estimates. Of course it is possible to work the variances from actual into the accounting records by using Standards for this class of overhead which may be

charged to Cost of Goods Sold but additional accounting ritual should always be shunned if it does not produce some practical facts which will be used by the executives.

In closing a word should be said of the all too prevalent attitude of authorities who presume to see a marked difference between so called Job Costs and so called Process Costs. It makes no difference whatever whether a lot of material is in process for a few hours in a given department or for an entire month; whether a lot is small and can readily be counted in a short time or whether a lot consists of many tons progressively put into production over an entire month. The calculation of a cost of either type of lot should be the same. Namely the allocation to the lot, of the quantities of Material used, the time spent by Labor thereon, and the amount of Overhead applicable according to the services rendered by the various departments through which the lot has been processed.

There is however a distinct difference in industry between the Repeat Industries where the same products are continually being made, and the "Special Industries" where a given product may never be made again and where each item of production is a new problem in itself.

The former industries yield themselves very nicely to the economies of Standard Cost Procedure and among them will be found the most successful installations if the executives in charge are the type who will understand and use the Standard Comparisons.

The latter industries largely make a travesty of Standard Cost Procedure, as at best the so-called Standard is only an Estimate which has been unwarrantably dignified by another title. It will never have sufficient history behind it to warrant the title and it will incur a great deal of accounting ritual which will not be a means to any practical or useful end.

Let us therefore always keep before us the goal of usefulness. Teaching all known reasonable theories but emphasizing the application in each specific instance, of only those theories which will be productive of practical, useful results.

# UNIT COSTS OF INSTRUCTION AT THE UNIVERSITY OF PENNSYLVANIA

H. I. MacLean

The accounting for expenditures, the distribution thereof and the final determination of the unit costs of instruction as developed at the University of Pennsylvania is somewhat indicative of the progress made by institutions in this particular field of accounting. A review of the early reports of the University shows that almost from the beginning there has been an attempt to publish the operating results and set forth the financial transactions of each period. In the report for the year ending August 31, 1882 separate statements of account for the various departments were published and departments were charged with a proportion of the tuition fees which was in turn transferred to the general fund in order to carry on the general purposes of the University. Subsequent reports to this, also indicate that the expenditures were allocated to the respective departments and instruction furnished by one department to another was considered and entered into the accounts. The allocation and distribution of costs appears to have followed a natural trend in the course of events. The early reports were prepared without a good many of the complex interdepartment problems which appear to prevail today.

Although it appears we are now steps ahead of our ancestors, nevertheless there are certain facts and questions which have arisen from time to time which indicate a definite need for revision, and perhaps restatement. However, it is my opinion that constant changing and restatement of accounts leads to such distortion of the results that the figures are not at all comparable. Anyone will admit that there are often good reasons for distributing expenditures in different ways. The following of one method does have its compensation for the figures are comparable and results may be studied. However, what we are doing today in the field of institutional accounting may appear to be an effort of an amateur to our successors in future years.

At the University of Pennsylvania, an accounting plan has been developed which fundamentally arrives at a deficit or surplus for each department, which in turn is closed into the general deficit account. We obtain figures upon the instructional salaries, other salaries and wages, and departmental current expense and distribute the general overhead of the various departments upon various bases, so that the cost system, which appears on the surface to be quite an elaborate set-up is in reality very simple. Through the distribution of our expenses we secure an analysis of instructional costs for each school upon the basis of student clock hours of instruction given.

### PREPARATION OF EXPENSES BY ORGANIZATION UNITS

In order that the preparation of the final figures may be understood it is unavoidably necessary to explain just how we arrive at the original figures before they are distributed. Budget request forms are first sent out to the various departmental budget administrators. These budgets include requests for the following:

1. Instructional Salaries
   (This includes the various members of the faculty actively teaching in the class room. As yet we have made no effort to break down the time spent by the various members of the faculty into the teaching hours and the hours spent in research.)
2. Other Salaries and Wages
   (Includes salaries of Dean's Office and clerical assistants, etc.)
3. Current Expense and Equipment

The budgets are assembled in a general budget survey which is guided by the estimates of income for the succeeding fiscal year. Of course all of the budgets are care-

fully reviewed by the various departmental budget committees and finally the respective Vice Presidents go over them so as to plan for the work that is to be done in the following year. Budgets, are finally submitted to the Board of Trustees for approval.

After the budgets have been approved salary cards are made out for the various members of the instructional and administrative staff. If a member of the faculty is teaching in, for example, the Wharton School, the Extension School and the Summer School, the salary to be paid for his position on each budget is listed. Payments then are made in accordance with the total of the detailed budgeted salary. At the end of the fiscal year the salary cards are compiled and distributed to the departmental expense accounts in accordance with the amounts budgeted. At this point we make a very careful final scrutiny of the figures in order to determine that the amount actually paid out is in accordance with the total of the amount of salary of each individual budgeted in order to effect a check upon the arithmetic and also to ascertain that we have distributed the salaries to the proper departments. The same procedure is followed with other salaries and wages. In case a department has a group on a semi-weekly payroll these costs are distributed in accordance with the foregoing plan except that no individual salary cards are opened up. The totals only appear as being charged to the department so as to establish suitable budget control.

The invoices for current expense and equipment after having been approved by the budget administrator and checked by the Purchasing Agent as to prices and extensions, are forwarded to the Comptroller for entry in the accounts. The invoices are all designated as to the account classification of current expense within the budget and are posted to detailed ledger cards on a bookkeeping machine. The bills are then filed and accumulated until the 15th or end of the month when they are entered in the combination invoice and check register, at the same time that the check is drawn. It has not been found necessary to open up an accounts payable inasmuch as the University of Pennsylvania has been fortunate enough to be able to pay its bills twice a month and discount the same whenever possible. At the end of the fiscal year we then have a total of the budget expenses by organized units for the following:

1. Instructional Salaries
2. Other Salaries and Wages
3. Current Expense and Equipment

It is realized that budgeted expenses do not necessarily have any relation to the income or receipts of any school or department due to the inter-relationship of the several faculties of instruction. It may be also noted that the budgets of the various departments do not include a charge for the building expense, general expense, or for instruction furnished by other school or departments. Separate budgets are of course prepared under budget administrators for building expense, and the various items finally closed into general university expenses. Later in this paper is a discussion of the method of charging the instructional expenses to the various schools and departments. It is believed to be beneficial to have the budget administrator of a school center his attention on the items of instructional salaries, other salaries and wages and current expense and not to divert unnecessarily his attention to such items as building expenses, etc., which are definitely under a centralized control.

At the close of the fiscal year a summary of the budgeted expenses by organization units is prepared showing the various departments grouped under the various boards. For example, there is listed under the Board of Liberal Arts the various departments of the College such as Anthropology, Astronomy, Botany, English, Geology, etc., and the actual budgeted expenses of each. Under the Board of Liberal Arts we also have the College Collateral Courses, College for Women and Summer School. The budgeted expenses of the Board of Business Education comprising the Wharton School of Finance and Commerce, the Evening School, the Extension Schools and the department of Industrial Research, are also shown in detail by departments. Thus we arrive at the total of instructional salaries, other salaries and wages, and

current expense and equipment by Boards. It seems as if it might be going to too great detail to tell all the make-up of the various Boards, but principally we have them grouped as follows:

1. Board of Education and Research
2. Board of Liberal Arts
3. Board of Business Education
4. Board of Fine Arts
5. Board of Engineering Education
6. Board of Teacher Training
7. Board of Law
8. Board of Medical Affairs
9. Social Committees
10. Executive Board.

The Executive Board includes the administrative and general expenses. When we have finished this statement of budgeted expenditures we have presented the educational expenses by Boards and a detailed schedule of all of our administrative and general expenses, which includes the offices of the various administrative officers, admissions office, alumni records, the costs of insurance, annuities, interest on loans, publicity, telephone service, etc. The expense of the maintenance and operation of the physical plant is also included under the Executive Board. All of the salaries in this Board are classified as other salaries and wages.

The total expenses of all of the Boards shows a total of all budgeted expenses for the year, which is quite informative in preparing budgets and can be used for comparative purposes to determine trends, etc.

### THE DISTRIBUTION OF INSTRUCTIONAL COSTS UPON A STUDENT CLOCK HOUR BASIS

At the beginning of each term the Vice President forwards to each department of instruction forms to be filled out by the various members of the faculty indicating the term teaching records of each member. The "term teaching records" indicate the name, rank, group and school, the number of hours the faculty member is in the classroom and the location of the classes. The faculty member also indicates on this form an analysis of the number of students in each school taking the courses being taught and the hours of instruction furnished to each department. On the basis of this information the term teaching records for each department are assembled and tabulated so as to show the total number of hours of instruction of each department and the participation in, or share furnished to each school by a department. Upon this information the percentage of participation in the expense of each department for each school is determined. In so computing and analyzing the teaching load for the first and second terms we have necessarily computed also the total number of hours of instruction in each school of the University.

After we have determined the distribution of the teaching load, we assemble the direct expenses of each department and add to that the general university expense and the building expense. The general university expenses, such as the costs of the library, telephone service, workmen's compensation insurance and other charges not directly budgeted by schools and departments are distributed to each of the respective departments upon the ratio that the instructional salaries of the department bear to the total instructional salaries of all departments. The building expense is proportioned upon the percentage of the building usage by the departments; that is to say, that at the University of Pennsylvania certain of our buildings are used by various departments. In preparing the term teaching records the faculty member notes the building in which he is teaching the course. We prepare a summary of the number of hours of instruction given in the various buildings and distribute the building expenses to the various departments on the basis of the number of hours used. There is no attempt made to distribute the building costs of the offices of the deans and the professors to the respective departments on account of the involved nature of such a task. The buildings which are used for general university purposes are closed into the general university expense account, which is later distributed to the various departments as mentioned before.

Thus, we now have the direct expenses, the share of general university expense, and the building expense, and a total which rep-

resents the direct and indirect costs by departments. Such total of departmental expenses is then distributed to the various schools upon the basis of the participation by the several schools in the instruction of each department, as previously determined from the analysis of the term teaching records.

After each school has then received credit for the instruction furnished and has been charged for the instruction furnished by other departments we arrive at the adjusted operating expenses by schools. The total income of the department, including tuition fees, income from invested funds, etc., is then subtracted from the total adjusted operating expenses in order to determine the operating deficit or surplus as may be the case. The total of the departmental deficit or surplus accounts results in the net operating deficit for the University for the year. The deficit of the University of Pennsylvania has in the past been provided for by various contributions and gifts and an appropriation from the State of Pennsylvania for maintenance of the institution.

### INEQUALITIES OF THE DISTRIBUTION

One fact is apparent from the foregoing that there is a certain inequality in the distribution of the cost of instruction upon a clock hour basis. For example, if the head of the department who generally is the highest paid man in the department devotes a major portion of his time to teaching graduate work it appears that the Graduate School should be charged in accordance with the facts. This of course is not done and therefore the Graduate School receives the benefit of the reduced costs of teaching in the undergraduate schools. In order to equalize this factor it would be necessary to analyze the teaching time of each faculty member and distribute the same to each department. This fact has not been considered sufficiently important to warrant the expenditures involved.

Another factor which is not considered in this system of arriving at costs is the matter of research. Of course the relationship of teaching and research is very close and go hand in hand. Some consideration it is believed should be given in the accounts to the actual time of a faculty member actually devoted to special research projects. Frequently, grants are received from the various foundations for specific projects. The faculty member who continues with his regular teaching load spends much time and effort on the project and the only funds that appear to be expended are the grants for materials, supplies and clerical assistance in connection therewith. In such cases the distribution of the part of the salary might well be made to the cost of the project being carried out. It is hoped that eventually some distribution and accounting for such expenditures may be worked out satisfactorily.

The distribution of general university expenses on the basis of instructional salaries is not always equitable. The distribution of the expenses of the operation of physical plant is open also to question. However, in the statements prepared the amount of the general university expenses and the plant operation expenses is clearly shown for each department so that in studying the reports there is no attempt to make such items obscure. It is believed that a clear understanding and statement of such items leads to mutual feeling of coöperation and good-will among the members of the staff of an institution.

### USES OF THE COST DATA

Cost Data if not utilized and studied is expensive and valueless. It is not infrequent that large expensive cost systems are installed and no use is made of the valuable information obtained. It is of course important that the information secured be prepared and presented to the executives and administrators in such a way that it is understandable and clear. May I here offer an opinion that it is not the fault of the layman that he often misinterprets the statement of the accountant for it appears that frequently the terminology of the statement, and form, is just not easy to read. It is the duty of the accountant, just as it is the job of the writer of history, to present his facts in a clear-cut, simple style. Frequently, terms that are understood well in the profession are quite

hazy to others. If the statement however is clear the executive should be able to properly interpret conditions.

We prepare a statement of the comparison of the per capita costs to the fees paid in which various facts are shown which have been determined in arriving at the costs as follows:

1. Total cost of schools
2. Student clock hours per week, per year
3. Cost per student clock hour per week, per year
4. Student enrollment
5. Equivalent regular enrollment
6. Costs per capita-equivalent regular enrollment
7. Fees paid per capita-equivalent regular enrollment
8. Percentage of cost covered by fees paid
9. Fees paid plus free scholarships and tuition grants per capita-equivalent regular enrollment
10. Percentage of cost covered by fees paid plus free scholarships and tuition grants

The foregoing information presents a general picture of the situation that exists in the various schools. It may indicate expensive methods of teaching or waste of materials or supplies or need for more students to well utilize the time of the professors. If the detailed expenses are scrutinized carefully a definite need for additional endowment for specific departments may be indicated. The general picture is at hand for comparison with other years to determine just what effect certain policies and measures have had.

Finally a table of curricula costs is prepared embracing the full four year period, estimated upon the previous finding. The curricula is selected by the Dean of each school and comprises subjects required for the degrees in the several schools. This table of course shows again the general picture which may point out the necessity for study in various departments.

When the general situation is shown it may be indicated that the curriculum cost in a department has increased rapidly or has not gone down in accordance with the general program of economies of which we all know too much today. It is then possible to ascertain the various details making up the cost. Frequently such questions arise and detailed statements are prepared to indicate the cause of such a situation and to indicate how to remedy it. The value of control through accounts of a large organization with which it is impossible for any one person to be thoroughly familiar with all the various details and ramifications is, and has been well proved.

It is not my opinion that this system as outlined to you is perfect or without fault. It is subject to improvement of course, but there has been established a system which is useful, satisfactory and which does work and presents the information desired.

# UNIT COSTS IN INSTITUTIONS OF HIGHER EDUCATION

T. L. HUNGATE

INSTITUTIONS OF higher education in America are facing important problems. In the decade from 1920 to 1930 the number of their students increased from 597,857 to 1,085,799, an increase of 82%. The number of colleges and universities which had shown no appreciable increase during the twenty-five years preceding 1920 increased during this decade from 670 to 1,078, and the number of teachers' colleges granting first degrees increased from 40 to 140. This growth in numbers of institutions and students was accompanied by an increase in income from $240,141,994 to $631,130,377 and by an increase in the book value of property from $1,202,880,547 to $3,280,054,245. The increase in student enrollments, the willingness of the people to bear taxes and to make gifts for support, are evidences of the American faith in higher education.

In this period, as in earlier periods, it was generally true that states were lacking in state policies and programs with respect to higher education. "Institutional growth and institutional prestige were the primary considerations, rather than a dovetailing of the programs of all institutions into the most effective scheme for providing a complete but economical system of higher education for the State." Moreover, "educational institutions, commercial assets to the communities in which they are established, were frequently created and located, not according to consideration of State interest, but rather because of local influence."[1] The development of institutions under self-governing boards has been accompanied by competitive struggles for funds, students, professors, and departments. "The consequence is an enormous amount of duplication of effort and failure to articulate with the needs of society."[2]

At the beginning of the depression the claims of institutions for support from student fees, taxation, gifts, and endowments had reached a total in excess of six hundred millions of dollars. At the present time, however, the ability of the people to pay taxes is reduced, and men and women who in prosperous times were able to assist in financing higher education now find themselves unable to do so. The yield from investments has declined. Many students who are eager to go to college are prevented from lack of funds. These conditions are found reflected in the incomes of institutions. Since the beginning of the depression reductions in income from 20 per cent to 40 per cent are common.[3] A few institutions had reserves to assist them in adjusting their expenditures to the reduced levels of their incomes, but the great majority were forced to reduce expenditures promptly in the best way they could in order to avoid disastrous deficits. In some instances economies were effected with respect to maintenance of plant where delay will serve to increase the outlay required in the future. In other instances the materials for teaching have been denied in order to maintain salary schedules, and reductions in salaries are general. While 27 institutions out of 197 institutions reporting have lowered tuition fees out of consideration of the financial problem of the student, as many as 39 institutions of the group have actually increased their fees since the beginning of the depression, in an endeavor to protect teaching standards.[4]

The adjustments which I have described have served the immediate purpose of bringing about a sound relationship between in-

[1] Kelly, Fred J., and Neely, John H., *The State and Higher Education: Phases of Their Relationship.* The Carnegie Foundation For The Advancement of Teaching, In Coöperation With The United States Office of Education. (1933).

[2] Counts, George S., *The American Road to Culture.*

[3] Circular No. 121. The United States Office of Education, September, 1933.

[4] Circular No. 121. The United States Office of Education, September, 1933.

come and expense, but it is doubtful if some of them should be retained from the point of view of long term policy. Most important in this respect is the present level of salaries of teachers. Of 173 institutions reporting, the most common salary for professors ranged from $1,200 to $7,000 per year, and in as many as 66 institutions, the most common salary of professors was $2,500 or less per year. Compensation for professional services which does not provide a comfortable living, means for furthering professional advancement, and security in old age is not in accord with public policy. It is therefore quite probable that unless these low salaries are raised teaching standards will be affected.

It is recognized that the total cost of higher education, whether in institutions publicly or privately supported, must finally be a charge upon the financial resources of the people. It is probable that institutional incomes will continue to be reduced for some time to come. It is important, therefore, to study expenditures with the view to assuring high standards for those desiring a college education at a cost which they can afford to pay.

There are two great areas of economy open to institutions of higher education. The first is in the field of institutional coördination on a regional or state wide basis. "Coördination means a working agreement as to the larger aims and objectives of education and the elimination of wasted effort through wide divergence of functions among like institutions. . . . The time has come when higher education without a comprehensive plan as a basis for a program will waste more financial and human resources than it uses wisely."[5] Already significant steps toward "better articulation and coördination of the programs of state supported higher education"[6] have been taken in the States of Florida, Georgia, Idaho, Iowa, Kansas, Mississippi, Montana, North Carolina, North Dakota, Oklahoma, Oregon, South Dakota, and West Virginia. As I view it, the great need appears to be state wide articulation and coördination of the programs of all the forces working in higher education, whether public or private.

The second great area of economy is in institutional internal administration. Somehow we must bring judgment to bear on the problem in order to provide the educational opportunities best suited to the greatest numbers and at the lowest possible cost. The educational services of colleges and universities may include instruction, research, and public service. Instruction is commonly provided in all institutions. Research is found as incidental to teaching in many institutions, but in large institutions considerable sums are expended, often from funds especially designated for the purpose. Public services represent advisory or consultative services for the public welfare which professors and teachers by reason of their studies are qualified to give. It seems reasonable that the cost of research and public service should be provided from sources other than from student fees, and that student fees should apply on account of the cost of instruction.

The cost of instruction includes the cost of all opportunities provided by the institution for the self education of students, including teaching, libraries, laboratories, physical plant, administration, and other services. We know that a wide variation exists in the opportunities provided in our 1,200 institutions of higher education. We know there are superior and inferior teachers, curriculums both well and ill adapted to the need, libraries adequate and inadequate, laboratories suitable and unsuitable, physical plants well and poorly designed, and administrations effective and ineffective. Our best institutions have high standards with respect to these matters. Our weakest institutions have not been able to maintain high standards in these respects. But in all institutions may be found elements of strength and weakness, and in all, wide variations in costs, both because standards vary and because salary scales and purchasing abilities are not the same.

The trend of cost of providing instructional opportunities is not enough to indi-

[5] Cottrell, Donald P., Teachers College Bulletin of Higher Education, January, 1932.

[6] Kelly, Fred J., and McNeely, John H., *The State and Higher Education*, 1933.

cate effective progress toward economy. It is necessary that cost be considered in terms of utilization. The cost of educational opportunities offered divided by the number of students availing themselves of the opportunities offered may be styled "Unit-Cost." There is inherent in mass education as we find it today the same principles of economy which operate in mass production anywhere. Low utilization of facilities will tend to bring about a high unit cost; high utilization of facilities will tend to bring about a low unit cost. It is possible for institutions with low standards, by reason of limited utilization of facilities offered, to operate at a higher unit cost than prevails in institutions of high standards and satisfactory salary scales whose facilities are well utilized. To date there are few reliable observations on costs, due not to failure to realize the value of such observations but rather to the entire lack of uniformity in institutional accounting and reporting.

A movement toward greater uniformity in college and university financial reports was started in 1929 by the United States Office of Education, with the financial support of the General Education Board. A nation wide Committee of representatives of associations of business officers and collegiate organizations was formed, known as The National Committee on Standard Reports For Institutions of Higher Education.[7] The Committee, under the Chairmanship of Mr. Lloyd Morey, Comptroller of the University of Illinois, has formulated principles to be followed in the keeping of accounts and in the preparation of financial and statistical reports in institutions of higher education. In 1931 the Committee published its "Suggested Forms For Financial Reports." These suggested forms with their accompanying principles have received wide recognition. Uniformity in accounting terminology, in accounting principles and in the form of reporting now prevails in many institutions throughout the country and there is strong probability that such uniformity will be generally extended. Thus for the first time in their history, the financial affairs of institutions are being similarly classified, described and reported. The effect of such uniformity should be far reaching in the study of costs.

The Committee has recommended that the Statement of Income and Expenditures be organized into three divisions:

(1) Educational and General, including the instructional, research, and public service activities of the institution.
(2) Auxiliary Activities, including the activities of dormitories, dining halls, and recreational activities.
(3) Other Non-educational income and expenditures, such as for annuities, financial campaigns, fellowships and scholarships.

Under each division income is to be classified by source, and expenditures by character and object, and the plan advanced permits uniform reporting by institutions which carry on educational activities under widely differing philosophies of support and with corresponding differences in the character of units for finance required. Careful attention has been given to accounting terminology.

The primary classification of expenditures by character as recommended by the Committee follows.[8]

A. Educational and General
   (Includes expenditures for instruction, research and public service.)
   1. General Administration and Expense
      (Includes all expense of the general executive and administrative offices of the institution, also all expenses of a general character which do not relate to any specific division of the institution, not including,

[7] The personnel of the Committee comprises representatives of the Association of University and College Business Officers of the Eastern States, the Southern Educational Buyers and Business Officers Association, the Association of University and College Business Officers (Middle West and Western), the Association of American Colleges and the Council of Church Boards of Education, the Business Officers of Pacific Coast Universities and Colleges, the American Association of Collegiate Registrars, with the coöperation of the United States Office of Education and the General Education Board.

[8] Suggested Forms For Financial Reports of Colleges and Universities. Bulletin 2. National Committee on Standard Reports For Institutions of Higher Education, July, 1931.

however, the expenditures of the general library or the operation and maintenance of the physical plant.)

2. Resident Instruction and Departmental Research
(Includes all expenditures on account of instructional departments of the institution, including salaries, office expense and equipment, laboratory expense and equipment, and other expenses. There should be included salaries of college deans, faculty, clerks, and technicians. Amounts reported under this heading will include any expenditures for research which are not separately budgeted and accounted for.)
    a. Colleges, schools or departments (list separately)
    b. Organized activities relating to instructional departments (Such as the medical school hospital, dental clinic, dairy, creamery, museums.)
3. Organized Research
(Includes as separate units such organizations for research purposes as research bureaus, research institutes, experiment stations, and projects separately supported)
4. Extension
(Includes expenditures for extension work such as credit courses, lectures, demonstrations, short courses, and correspondence work.)
5. Libraries
(Includes the total expenditures of the institution for library purposes, including both the general library and all departmental libraries. There should be included salaries, other operating expenses, purchase of books and binding.)
6. Operation and maintenance of Physical Plant and Other General Services
(Includes the expenses of operation and maintenance of plant which houses educational activities. Also includes general charges such as property insurance, and rent of property for educational purposes.)

B. Auxiliary Enterprises and Activities
(Includes gross expenditures for the operation of residence halls, dining halls, bookstores, and inter-collegiate athletics. Appropriate charges for operation and maintenance of physical plant and other general expenses should be included.)

C. Other Non-Educational Expense
(Includes expenditures from current funds on account of items which do not relate to the educational work of the institution, such as annuities, interest, fellowships and scholarships.)

With a logical presentation of expenditures in institutions of higher education now being gradually brought about, the Committee has turned attention to unit costs, first by causing a study to be made of "Methods Used in Unit Cost Studies in Higher Education,"[9] and next, in coöperation with the National Association of Collegiate Registrars, by publishing "Suggested Forms for Enrollment Reports of Colleges and Universities."[10] The purpose here was to foster uniformity in reporting of student enrollments, and to secure enrollment reports which could readily be considered in connection with financial statements. Its most recent bulletin is entitled "Suggested Methods and Forms For Use in Unit Cost Studies in Colleges and Universities."[11]

In this bulletin the Committee recommends two units on which costs may appropriately be based. These are the full time student equivalent, and the student credit hour. The full time student equivalent represents one student carrying a full normal academic load. Because of the present tendency away from formal courses and credits in many colleges and universities, the individual student is coming to be considered as the most significant unit for cost studies. A satisfactory method of reducing all registrations to the value of full time students has been developed. The full time student equivalent is recommended in computing costs both for the institution as a whole and also for schools, colleges, or other major division of the institution.

The second unit recommended for use in cost studies is the student credit hour. This unit represents one student under instruc-

[9] Methods Used in Unit Cost Studies in Higher Education. Bulletin 3. National Committee on Standard Reports For Institutions of Higher Education. (July, 1932).

[10] Suggested Forms for Enrollment Reports of Colleges and Universities. Bulletin 6. National Committee on Standard Reports For Institutions of Higher Education. (October, 1932).

[11] Suggested Methods and Forms For Use in Unit Cost Studies in Colleges and Universities. Bulletin 8. National Committee on Standard Reports For Institutions of Higher Education. (July, 1933).

tion for a period of time for which one hour of credit is granted. Because of the fact that credit hours are not always comparable in different institutions, the use of this unit should be limited to intra-institutional studies. Even here, care should be taken that this unit is comparable in the different divisions of the institution.

Given the expenditures of the institution classified after the manner recommended by the Committee, the next step is to distribute these expenditures on a functional basis, in order that consideration may be given to the method of finance for each function, and in order that the unit cost of resident instruction and extramural instruction may be ascertained. For this purpose five columns are suggested as follows:

1. Resident Instruction
2. Extramural Instruction
3. Organized Research and Public Service
4. Auxiliary Activities
5. Other Non-Educational Expense.

Resident instruction and extramural instruction are separately considered because extramural instructional facilities are usually more limited and the student is expected to pay the full cost. Research contributory to teaching is considered an appropriate charge to instruction, provided that no reduction in the normal full time teaching load has been granted. Organized research and public service should be financed from sources other than student fees and are not immediately essential to carrying on the instructional program.

It will be observed that expenditures for auxiliary activities are separately provided for. This is desirable because dormitories, dining halls, bookstores, and other units are frequently administered with the intent that the student shall bear the full cost or a stated portion of the cost. If the intent is realized, it can be demonstrated only if all items of expense are charged to the unit. Charges for various services are frequently overlooked with the result that the authorities and friends of the institution are misled into believing that the unit is more profitable than the facts would reveal. Services may be rendered by the financial office, by the community post office, and by college telephone operators. Supplies may be requisitioned from the institutional store of supplies. Plant space may be used which calls for rent, heat, water, light, and power. Charges for each of these services should be made to each unit served.

The items which appear as Other Non-Educational Expense enable authorities to consider them in relation to the manner in which they are financed.

The Committee provides for two methods of computing unit costs. The first is for use in those institutions whose educational functions are limited to resident instruction. If the classification of expenditures follows that recommended by the Committee, the financial figures may be taken from the annual financial report. Enrollment figures may be taken from the enrollment report if such report has been prepared in conformity with the recommendations of the Committee. By dividing the cost of resident instruction by the full time student equivalent, the net instructional cost per full time student equivalent is obtained.

The second method of determining unit costs involves the distribution of expenditures to functions in a detailed procedure, based on complete analyses of all of the instructional expenditures of an institution. The Committee recommends detailed procedures for obtaining the distribution of faculty salaries and the allocation of overhead expenses, including administration, libraries, museums, physical plant. The resulting distributions divided by the full time student equivalent or by the student credit hour unit will provide the unit cost.

The Instructional costs computed in the detailed procedure, the administrative bases for computing the costs, and the units to be employed may be summarized in the following manner.[12]

In a complete cost study, all the cost figures listed in the table will doubtless be de-

[12] Suggested Methods and Forms for Use in Unit Cost Studies in Colleges and Universities. The National Committee on Standard Reports For Institutions of Higher Education. (July, 1933.)

| Costs | Administrative Bases* | | | | |
|---|---|---|---|---|---|
| | Department | Division | Institution | Student Level | Curriculum |
| I. TEACHING COSTS | | | | | |
| A. Teaching salaries | SCH | SCH or S | S | — | — |
| B. Teaching supplies | SCH | SCH or S | S | — | — |
| C. Total teaching costs | SCH | SCH or S | S | — | — |
| II. OVERHEAD COSTS | | | | | |
| A. Administration | SCH | SCH or S | S | — | — |
| B. Libraries | SCH | SCH or S | S | — | — |
| C. Physical Plant | SCH | SCH or S | S | — | — |
| D. Total overhead costs | SCH | SCH or S | S | — | — |
| III. TOTAL CURRENT INSTRUCTIONAL COSTS | SCH | SCH or S | S | S | S |

* SCH indicates student-credit-hour unit; S, full-time-student equivalent unit; —, costs not computed.

sired. Teaching salary costs, total teaching costs, total overhead costs, and total current instructional costs computed for departments, divisions, and for the institution as a whole, undoubtedly will be of major significance. Costs of instruction for the junior college level, the senior college level, and the graduate level, and by curriculums, may prove to be of value. The Committee has prepared detailed recommendations for the computation of these unit costs which will not be here discussed.

Unit costs are estimates. Such estimates, however, should become increasingly useful in internal administration. By their use, the financial officer has opportunity to present the actual and estimated outcomes of adopted policies and the implications of yet to be considered plans. Trends in unit costs both direct and indirect, in department, division or institution as a whole, become apparent. The significant thing is not solely the amount of expenditures, but the amount of expenditures in relation to utilization, or the unit cost. Thus unit costs which I have discussed I regard as a tool, the potential uses of which are little considered and little understood. It is an effective method of expressing the cost of the educational program of the student. It represents the summary of all of the cost variables and so is of use in internal administration. In a larger sense, it may become a tool in the building of a regionally planned system of higher education, in which the greatest opportunities may be provided at the least cost per student. Only in this way can higher education hope to extend itself—by providing opportunities at a cost which the student and the public can bear to pay.

# THE ACCOUNTING INSTRUCTOR AND LOCAL GOVERNMENT ACCOUNTING

H. T. Scovill

Accounting as an aid to business management and control has been improved so greatly in the United States during the last twenty-five years both in development of principles and the application thereof that all those who have assisted in such progress may well feel proud of their achievements. Several groups of people have been responsible for, and have participated in, this movement leading to better business administration, among which might be mentioned, certified public accountants, educators, bankers, capitalists, business executives and governmental agencies.

Passing by the others for the moment it might be observed that the last named group, governmental agencies, have rendered assistance principally through the administration of requirements, enforceable by them, for adequate accounting systems, comprehensive financial reports and specified methods of verification or auditing of results. The most common examples of businesses which have been, and are, subject to such requirements of governmental agencies are railroads, local utilities, banks, building and loan associations, and insurance companies. Considerable progress has been made in the development of accounting, reporting, and auditing principles and technique devised for these lines of business by the several federal and state governmental agencies in exercising their control. The regulation, at times, has not been as intelligent, forceful and adequate as public interest should require; but any deficiency in such respects has been caused by elements within the regulatory bodies rather than by the inadequacy of accounting records and procedures, or incompetency of accountants in the business houses themselves who record, summarize and report the results of business transactions. In other words, the accounting system, the bookkeeping technique and reporting methods are very well developed in railroads, public utilities, banks, building and loan associations and insurance companies; and if good, honest, effective regulation and control are not experienced, the reason should be sought elsewhere.

While the governmental agencies just mentioned have used their influence and authority in applying good accounting principles from time to time in the semi-public institutions under their control, many private business units have also kept abreast of the times in this respect by adopting satisfactory systems and employing well trained accountants to supervise the work and audit the accounts. Such adoption of accounting policies by business concerns in general has been the result of effort and initiative, not alone on the part of individual officers or managers, but on the part of groups of individuals within the same kind of business, or in some allied or related business; or it has been the result of some statutory requirement which has not gone so far as to prescribe a specific system but which asks for information of such a character from time to time that there is offered a strong incentive for business organizations to keep accounting records in accordance with recognized principles and practices.

Among such groups of individuals, allied businesses and statutes offering the incentive are the following:

1. Trade associations through the formulation and adoption of uniform systems of accounting, with the coöperation of the Federal Trade Commission.

2. Federal Reserve Board which sponsored the pamphlet on Uniform Accounting in 1917, and its successor Verification of Financial Statements in 1929.

3. Robert Morris Associates which has done much to encourage proper accounting and auditing by business concerns of all types.

4. Stock Exchanges in some metropolitan

centers through their recent requirement that audits by independent auditors be made of all corporations applying for the listing of securities.

5. Income Tax Laws (Federal and state) which produced probably the biggest incentive in the last twenty-five years for the average business to keep reasonably complete records of its transactions.

6. National Recovery Act which through its sections on codes created a profound interest in costs and other accounting concepts and gave trade associations an incentive to foster and revive interest in uniform accounting systems, with particular emphasis on the general inquiry as to what constitutes "selling below cost."

7. Federal Securities Act and recent State Corporation Laws that include provisions for accounting and auditing which, although not in line with orthodox practice in all respects, are nevertheless encouraging a further recognition of the importance of accounting in business and the relation of the practitioner with the public.

In addition to the influences specifically enumerated above other indications and trends might be cited to show that in private business affairs, accounting and accounting supervision have developed remarkably in the last twenty-five years. One prominent feature is the rather general creation of positions of comptroller, chief accountant and internal auditor in the larger industrial and financial institutions. Another is the fact that many of the subordinate positions in the accounting department are occupied by employes who have had formal training in the principles of accounting.

Thus both in the skilled personnel entrusted with the handling of the accounting work in the modern private business corporation, and in the accounting system itself one sees that there is a marked desire to obtain the best available, to the end that the management may be guided by reliable data, intelligently interpreted. The directors and stockholders of the corporation have learned to expect such things and would not be satisfied with any less effective procedure and personnel.

### PRIVATE AND PUBLIC CORPORATION CONTRASTED

How about the stockholders (i.e. taxpayers and other voters) in a public corporation, however, such as a municipality? Are they interested in having an adequate accounting system supervised and interpreted by properly trained accountants? It seems in general that they are not; and yet the stockholders in the two cases, the private and public corporation, are the same individuals in part. Why should these people in one case demand adequate control while in the other they do not? This is a question which we shall not attempt to answer. It is a question, however, a satisfactory solution of which would doubtless eliminate much of the extravagance and misdirected effort in government.

It is our purpose at this point merely to refer to some of the inferior accounting systems in local governments and comment on the lack of intelligence in their operation and in the interpretation of the results thereof. Such lack is caused generally by a partial or complete absence of knowledge of accounting principles and procedures on the part of those elected to fill not only administrative positions but also those positions in which the major duties involve the keeping of records or supervisions of financial affairs.

It seems that no type of local government has a monopoly on the ignorant, indifferent, extravagant, or dishonest office holders or on systems of accounting which reveal nothing. Such creatures are found not only in city governments proper but in other local taxing bodies operating independently of the city administration, such as school districts, park districts, sanitary districts, townships and counties. (Of course we are not attempting to refer to state and Federal governments at this time.)

### SOME UNSATISFACTORY PUBLIC RECORD KEEPING

Among the numerous cases which might be called interesting if they were not so appalling, and which have come to our attention are these:

(a) A supervisor of a rural township spending only $15,000 a year kept all of the funds of the township in his own personal bank account with the full knowledge and consent of his banker and was found to be $12,000 short in his accounts after serving six years. Ignorance of bookkeeping methods was his plea.

(b) In a city of less than 50,000 population, a tax was levied for garbage disposal for several successive years, one year the amount being ten times as much as the City Council authorized, because of a misplaced decimal point. The total amount levied, however, was kept in the general fund because there was no special use for the fund at that time. No entry appeared on the books of the city to record the liability of the general fund, and the misuse of the funds was overlooked.

(c) The Circuit judge of a district assesses fines frequently against people brought before him for criminal action. The Circuit Clerk's record of court decrees showed in a certain county a number of cases in which fines were assessed to be collected in monthly instalments; and others where costs were assessed against defendants. No ledger was kept by the circuit clerk in which to record such fines and costs, and as a result the existence of such receivables was not brought to his attention from time to time through the medium of a trial balance. They accordingly remained uncollected for an indefinite period, or at least the cash book did not reveal collection of such items.

(d) The sheriff of a county in his annual report showed nearly $5,000 in fees "earned but not collected." They were shown as fees earned presumably because they came from other county offices where the source could be easily traced. Why they were not shown as collected no one knew. No ledger accounts were kept and accordingly these so-called fees "earned but not collected" were not regularly entered as specific charges. As a result in the report of the subsequent year no collections were shown from the receivables on hand at the beginning of the year but on the other hand they were dropped completely from the report. In their place appeared another amount similarly listed as fees "earned but not collected" which amount was traced as the aggregate of fees paid during the current year to the sheriff by other county officers. And so it went for several years, the receipts for fees being called "receivables" but the receivables in turn never being accounted for as ultimately collected. Probably this is an instance involving poor accounting system, improper training of the sheriff's bookkeeper, or even a false code of ethics.

(e) In a city of 50,000 population the city clerk made up a list of estimated receipts including $120,000 of proceeds of anticipation warrants and when the estimate of disbursements exceeded the estimated receipts he said "It never does balance, and the expenditures always exceed the estimated revenue."

(f) In another city of medium size, the city clerk does not keep a general ledger. He keeps only a memorandum record of expenditures by departments on a working sheet. When the total of any column reaches the total amount appropriated for the purpose indicated, he records expenditures therefor in other columns that have not yet reached the amount of the appropriation.

(g) In two other cities of medium size, the city clerks make entries intentionally to some other accounts than those that should be charged so as to make the records appear as though all expenditures are within the appropriations.

(h) The fines which are assessed by the police magistrate or justice of the peace are supposed to be collected by him. Many cities have lost revenue because of careless methods and lack of control over such collections. In the case of 29 out of 56 cities studied in Illinois it was found that during 1930 the police magistrates kept no definite system of records and that they reported and remitted not oftener than once a month. Their reports were accepted without any check or audit. Fines assessed which were to be collected later were not entered as Fines Receivable on the City Clerk's records and much revenue was lost because the magistrates and justices failed later to collect or at

least to account for the collections of fines.

(i) The police magistrate in another city of nearly 50,000 population was found to be about $6,000 short in 1931 having kept the collections in his personal bank account and lost them in speculation. In another city of similar size the magistrate had held office for a quarter of a century and always followed the practice of reporting his collections only once a year. He kept all receipts in his personal bank account and collected interest on the balance. No audit of his accounts has been reported.

Experiences of the types referred to in the foregoing cases could be multiplied many times. That they are the rule rather than the exception is the alarming feature in these cases. As an illustration of this we quote from the thesis of Dr. W. E. Karrenbrock of the University of Illinois Accountancy staff who, in 1932 made a study of the Administration of Municipal Funds with Special Reference to Illinois Cities. He studied eight of the larger villages, twenty-four cities operating under the aldermanic system and twenty-four under the commission form of government, not including Chicago which might be presumed to be large enough to enable it to transact and record all of its affairs satisfactorily.

In his summary Dr. Karrenbrock says, among other things:

"Six of the eight Illinois villages do not prepare budgets. Of twenty-four aldermanic cities eighteen did not prepare budgets for the 1931 municipal year. Of twenty-four cities, that have the commission form of government, only four made an honest effort toward preparing a systematic budget. The other twenty cities did not prepare budgets in which one would be able to find the amounts of actual expenditures of 1930, the anticipated revenue for 1931, and the estimated expenditures of the year 1931.

"One of the fifty-six cities studied did not pass an appropriation ordinance. However, a tax levy ordinance was prepared and passed. It was also shown that city officials have not clearly understood the distinction between a tax levy ordinance and the appropriation ordinance. An undesirable practice, which causes a loss of control over expenditures, is the appropriating of amounts much greater than the total revenue can possibly equal. Illegal transfers between funds have been made. Thirteen cities have made either no entries or incorrect entries on their books and therefore did not know whether or not they were keeping expenditures within appropriated amounts.

"In some cases proper segregation of cash and other assets as between funds was not attempted. The general and personal property taxes, according to law, should be distributed to the proper funds on a percentage basis which must be calculated for each tax levy ordinance of each city. Only nine of forty cities make and use such a percentage calculation. Approximately forty-four per cent of the cities studied do not maintain the required Police Pension Fund, and approximately fifty per cent of the cities do not have the required Firemen's Pension Fund. Of twenty-nine water plants owned by cities, only four have prepared what seem to be approximately complete balance sheet and profit and loss statements.

"Many cities have lost revenue because of careless methods and lack of control over collections. In the cases of twenty-nine cities, we find in 1930 the police magistrate kept no definite system of records and that he reported and remitted no oftener than once a month. His report was taken as presented without any check or audit being made. Only eight cities and villages made a monthly check or audit of the police magistrate and justice of the peace records.

"Forty-two or forty-four cities do not maintain separate general ledger accounts for assessments receivable by instalments and have no separate instalment interest accounts. Seventeen city treasurers do not have separate cash accounts for each special assessment. In several cities the treasurer keeps no records whatsoever. The lack of correct segregation of cash balances has caused the retirement of bonds from cash that was not available for that purpose. An overdraft of over $200,000 existed in certain special assessment funds in 1931. Several cities would make a saving by following the

legal requirement of issuing bonds on special assessments at par plus accrued interest."

After thus summarizing the malpractices found in representative cities in Illinois Dr. Karrenbrock assumes that Illinois is not the only state in which it is so easy to be careless, ignorant or crooked; and then proceeds to make seventeen recommendations, one of which is the following:

### COMPETENT OFFICIALS NEEDED

"Only competent officials and office personnel should be chosen. There can be no assurance of the proper administration of funds unless the comptroller, the city clerk, and the commissioner of accounts and finance have a thorough knowledge of accounting procedure as it applies to the various municipal funds. The officials should also, before being allowed to enter office, know the laws which affect the methods of handling funds. It might be feasible to have a committee on municipal accounting, similar to the present state committee for Certified Public Accountant examinations, that would have the power to grant a certificate to those persons qualified for the above named municipal offices. It might be required that each applicant must have two years of college or university credit in general accounting and one course in specialized municipal accounting. He should at least be required to pass an examination, which is to be set by the committee, covering general accounting, municipal accounting, and the laws affecting the administration of funds."

It is on this recommendation that all friends and advocates of honest, economical government should focus attention, recognizing that at the present time approximately 20% of the total income of the United States is expended by local governments such as townships, school districts, cities, park districts, sanitary districts, and counties. Dr. Karrenbrock's thesis did not touch any of these except cities, which of course in these days spend only about 30% of the taxpayer's dollar collected for local governments within the state.

In 1930 nearly three and one half billions of dollars was spent by cities of 30,000 population and over. With school districts, counties, and townships spending such large amounts also, it seems almost a calamity that the American people should continue to elect to office those who are so incompetent in guiding the financial affairs and in keeping and interpreting records to assist in such guidance.

It is recognized of course that accounting systems themselves cannot make people honest, but it is maintained that adequate systems will enable honest and well meaning public officials to administer the affairs much more successfully. It has been our experience that the majority of public office holders are honest but they are misdirected in framing policies because they do not have complete and properly interpreted facts before them. Many others enter office with intentions of being honest, but the lax accounting methods in effect make it so easy to be otherwise that they ultimately are able to live extravagantly on a small salary.

Keeping and supervising the accounts of a municipality and assisting the administrative officers through the medium of timely and proper information requires in our opinion a higher degree of intelligence than does such a position with a mercantile concern handling a similar volume of business. In addition to preparing budgets, keeping the various funds properly accounted for and preparing statements for administrative guidance, they must know the numerous legal requirements affecting municipal affairs. What training however do the voters and taxpayers recognize in casting their ballots for such officers? It is safe to say they do not have any type of appropriate training in mind. They are merely influenced by the smooth methods of the political bosses and sympathy for some one who is out of a job or who has failed in trying to carry on his own business. They seem to think that it is possible for one to look after public business satisfactorily even though he has failed miserably in conducting his own business of much smaller size.

An indication of the qualifications possessed by office holders who keep important city accounting records and help direct the

financial welfare of the city may be obtained from the following specific cases from among those reported in Illinois:

City #1. City clerk and his assistant bookkeeper know nothing about principles governing correct record keeping. They rely on the auditor, a certified public accountant, to direct them and to give detailed instructions from time to time which they try to follow.

City #2. The city collector and treasurer was a coal salesman before taking office and had never studied accounting nor kept books. (The accounting system was installed by the cashier of a bank.)

City #3. The city clerk and city treasurer occupy the same room in the city building. They had no training for their positions. The records are in terrible shape. They cannot even determine the amount of their bank balances.

City #4. None of the city officials knows anything about double entry bookkeeping. The city clerk is a real estate man.

City #5. The city clerk keeps the books of his office and those of the city treasurer. He is about 75 years of age and had been a postal clerk for nearly 50 years before election to the office. He knows nothing about keeping a balanced set of records.

City #6. The commissioner of accounts had been a policeman who knew nothing about accounts. His records were in a hopeless tangle and the financial affairs of the city were so jumbled that no credit could be obtained from any source.

City #7. The city clerk had been for a short time a clerk in a small store. A very good accounting system had been installed but he could not handle it.

City #8. Paymaster for a coal mine for twenty years was the basic training of the city clerk in a prominent city.

City #9. In a well known city of medium size the city clerk received his only training for the position by working a number of years as a meat cutter. He had no knowledge of accounts.

City #10. The comptroller of a city of over 40,000 population was an auto salesman before "getting into politics." He knows practically nothing about the accounting system he is supposed to control.

City #11. From cigar store clerk to city clerk is the boast of one official who had never tried to keep accounting records before and who is doubtless well on the way towards involving the city in financial entanglements.

City #12. In this place the commissioner of accounts and finance knows nothing about city records; he operates a small store. The city clerk knows nothing about bookkeeping or accounting.

City #13. The city clerk does not know how to keep funds separated. The treasurer keeps no records.

City #14. The city clerk and bookkeeper had no training in accounting according to their assertions, and the results lead one to believe them.

City #15. The treasurer and collector does not know much about municipal record keeping and admits his books are not in very good shape, but says he cannot see any reason for trying to improve them because every two years some one else will be in office.

City #16. The treasurer and comptroller are without any accounting qualification. The clerk who has held office nearly 20 years could keep a more complete set of books if one were designed but he seems to be able only to follow a fixed routine.

City #17. The records were in terrible shape as kept for the last 30 years by a cripple who is successful in getting votes.

City #18. The city clerk, a former factory laborer, can neither keep nor understand the records of a bookkeeper who also admits he does not understand them.

City #19. The commissioner of finance and accounts has had no accounting training. The city clerk has no knowledge of bookkeeping except that obtained in the office recently.

City #20. A young lady with no accounting training or experience keeps the records in this municipality.

City #21. Conditions in this one and two others are very bad, as most of us might infer from the fact that no officials know any-

thing about municipal accounting in any form.

City #22. The records of this city were entrusted to the tender care of a coal miner. They look as though he has not dug very deep for accounting knowledge. The treasurer, a former clerk, does not know how to keep his accounts.

City #23. The city clerk obtained his training as a clerk in the post office, and showed in several respects that he was not qualified for the position.

### VOTERS CAN IMPROVE CONDITIONS

If conditions as bad as even the best of the 23 cases just cited existed in the accounting department of a well regulated business establishment they would be remedied at once. The officers and board of directors would not tolerate such loose and extravagant methods nor such poorly prepared employes. In the cases of cities and other local governments the clerks, treasurers, and similar employes entrusted with the books of account are elected by the people so that the mayor and city council in any case do not seem to have the right to remove even the most incompetent individual. Some mayors and councils moreover through ignorance or otherwise pay little or no attention to results and trends even when presented by officials.

It seems then that the voters are the ones who must correct the evil of incompetence, giving some attention also to the evil of unsatisfactory records. We believe, however that well qualified officials in charge of accounts would soon reduce materially the defects in the accounting systems.

How can voters be made to realize that they themselves are secondarily, if not primarily, the cause of much of the waste and extravagance in local governments? Can they be induced to appreciate that a start at least toward the improvement of such conditions can be made by the proper selection of record-keeping officials, even if a more careful selection of chief executives must be deferred until later?

Some improvement has doubtless been made in selecting officials with better training during the last fifty years, but the training has not kept pace with the responsibilities of the positions. Accordingly an official who would have been considered well qualified to handle the records and finances of a city of 50,000 people 50 years ago would be adjudged entirely incompetent today. The difference lies in the fact that local governments have become much more complex than they were before municipalities were expected by their citizens, or were compelled by state legislatures, to render so many different types of service on so large a scale and in such an elaborate manner. Today the numerous types of tax levies, the special funds with their intricate legal requirements, the bond issues and redemptions, the budgets and appropriations required by statute, and the ever increasing complexities of special assessment accounting in addition to the several newer forms of revenues from fees and licenses make the job of keeping city accounts one that should be occupied only by one trained in accounting.

### A COMPETENT OFFICIAL MORE THAN PAYS FOR HIMSELF

The average taxpayer probably does not appreciate the savings which could be made and which are effected in some cities by those city officials, responsible for accounts, who are well trained for the work. We dare say the savings in almost any municipality would be such that present salaries of such officers could be doubled and the city would still be operated at a much lower cost than with the more poorly prepared officials.

If the scope of our subject were not limited to local governments we could speak at some length also on the desirability of electing a certified public accountant or similarly qualified person as in Pennsylvania to fill the position of state auditor of public accounts and supervisor of banking, rather than electing a bar tender, cigar store clerk, or just plain ward heeler to the position which has so much to do with molding the stability of our state banks.

PUBLIC PRESS AND STATE OFFICIALS HELP THE CAUSE

That some progress has been made in the right direction during the last three years is evident from the numerous instances in which prominent newspapers, state legislatures or state executives have proposed or passed laws or made recommendations in the interests of better control of finances of local governments. The following typical cases reveal the thoughts of newspaper editors, legislators and state executives on such matters.*

(a) The Governor of South Carolina in his annual address to the General Assembly in (1930) urged that an audit be made at least every two years of all offices where public funds are collected and handled both state and county, such audits to be by disinterested certified public accountants.

(b) The *Atlanta Journal* for September 15, 1930 announces that the Mayor of that City recently sent letters to accounting firms in Atlanta inviting them to make surveys working toward a unified system of accounting for all municipal districts.

(c) The Bureau of Public Research of Jacksonville, Florida, employed a Certified Public Accountant to audit the accounts of the municipal docks and terminals on the principle that all city owned utilities are the property of the citizens. The audit revealed that the docks and terminals have been operated over a 12 year period for a total loss of $450,000.

(d) The *Philadelphia Ledger* for September 29, 1931 in an editorial urged that an independent audit of the city's books be made.

An audit, it is said, should set at rest the constant disputes about the amount of the city's debts, its bonding capacity, and the excessive appropriations demanded for the sinking fund.

(e) Periodical audits of the books of all county officers by independent auditors are strongly recommended editorially by the *El Paso* (Texas) *Times* of January 17, 1932.

* As reported from time to time in the Bulletins of the American Institute of Accountants.

(f) An editorial in the *Norfolk Ledger Dispatch* of June 20th, 1932, earnestly recommends a complete audit of the affairs of Norfolk by an independent public accountant and particularly emphasizes the desirability of selecting auditors on the basis of ability and reputation rather than choosing the lowest bidder.

(g) Kansas House Bill 390 in 1933 provides for appointment of county auditors, for counties of specified population, to be appointed by the state tax commission. The bill passed the house.

(h) Kansas Senate Bill 452 in 1933 contains a provision requiring independent audit of taxing districts. It specifically authorizes the conduct of such audits by certified accountants.

(i) Nebraska House Bill 169, introduced January 19th, would provide for annual audit of the books and accounts of certain county officers by certified public accountants.

(j) Oregon House Bill 497 in 1933 would require the state auditor to effect an annual audit of the accounts and records of justices of peace and the district courts of counties of less than 100,000 population. The bill provides for the employment of "accounting experts" to make the necessary examinations.

(k) House Bill 182 (1933) introduced in the Utah legislature February 17th would give any taxpayer power to appoint an auditor to examine the accounts of any city, school district or county.

(l) A bill providing for the audit of each county in Delaware by a certified public accountant was reported favorably in the house March 2nd and a substitute was passed March 30, 1933.

(m) Georgia House Bill 733, approved by the governor March 24th, (1933) provides among other things that the board of commissioners of roads and revenues for the county of Twiggs shall cause an audit by a certified public accountant of the books and accounts of the tax collector, the tax receiver, the treasurer, the sheriff, the superintendent of schools and the commissioner of roads and revenues.

(n) House Bill No. 592, approved by the governor of Georgia March 10th (1933) provides that the grand jury shall appoint a certified public accountant or a firm of certified public accountants, non residents of Toombs County to audit the books and accounts of that county and its officers.

(o) Missouri Senate Bill No. 77 passed the legislature and was approved by the governor February 24th, (1933). It authorizes the governor to cause an audit of the accounts of political subdivisions.

(p) Oregon House Bill No. 497, as amended, providing for annual audit by a competent accountant of the records and accounts of every justice of peace, was approved by the governor March 16th, (1933).

(q) An editorial in the *Wilmington Journal-Every Evening* of April 15th (1933) discusses favorably a bill in the Delaware legislature intended to require audits by certified public accountants of the accounts of Delaware counties.

### AN APPEAL TO ACCOUNTING INSTRUCTORS

Inasmuch as accountants are the first ones who should recognize the necessity of good accounting records and intelligent operation thereof, they should likewise to the ones to initiate or support actively well formulated movements to improve either the accounting system or the caliber of its keeper and supervisor. Accounting instructors are in an especially advantageous position to assist in bringing these phases of municipal government to a higher plane, both directly by their efforts in their respective districts and indirectly through dissemination of information among students their several local communities.

Specifically the American Association of University Instructors in Accounting should assume as one of its major objectives that of promoting better accounting systems and obtaining more fully qualified accounting officials in all governmental affairs beginning at home with the local governments. They should not overlook in this connection the county board of supervisors, a very important body often reeking in graft and indifference and spending much of the tax payers' money but usually considered unimportant by the voters. Among the special objectives of a movement along these lines which might be encouraged through legislative action or creation of public sentiment are the following:

1. Selection on a merit basis of officials keeping or supervising accounts.
2. Payment of adequate salaries to attract well qualified candidates or applicants for accounting or financial positions.
3. Establishment of reasonable tenure of office for such officials.
4. Adoption of a system of accounts commensurate with volume and complexity of modern municipal and county transactions.
5. Compulsory annual audits of accounts of municipalities and counties including all funds, police records and special assessment accounts.

If accounting instructors will use some of their energy in their respective states toward accomplishing some or all of these five objectives either personally or through organized groups; or by enlightenment of students considerable progress can be made. Other desirable changes might follow these fundamental ones. The task is not as hopeless as some people might believe. It is, however, one which cannot be accomplished except by gradual and persistent portrayal of the reasonableness and inevitableness of the proposition to the voters through the public press, the chambers of commerce, service clubs, women's clubs, labor unions and other civic organizations which should be interested in restoring the operation of local governments from their present condition of virtual bankruptcy to that of a well regulated private business.

We pointed out at the beginning that adequate accounting systems and qualified accounting officers have been of great assistance in the development of healthy enterprises. We are sure they are just as necessary in the operation of honest and economical administration of local governments, and that they can be obtained if each of us will do his part and the Association will lend its support.

# THE PUBLIC ACCOUNTANT AND LOCAL GOVERNMENT ACCOUNTING

William H. Welcker

Government today in almost any phase is big business. The average municipal corporation is large in comparison with the average private commercial enterprise. It is hardly necessary to elaborate upon this point by extensive illustration. Generally speaking, the condition of public records at present is far from being up to the standard of those of private businesses of comparable size. The financial condition of municipalities at the present time and the lack of municipal credit, however, have resulted in much publicity and consequent interest in the efficiency of or lack of information upon municipal operations.

The purpose of this paper is to convey some idea of the relationship of the public accountant to local government accounting, and not to attempt herein to lay down any rules for the accounting procedure of local government. Our remarks will apply to the smaller divisions of government and will not embrace the accounts of the Federal Government, states or the larger cities. Very likely the smaller units merit our attention to a greater extent since there are departments functioning to some degree for the auditing of the accounts of at least many of the bureaus of the Federal Government, the states and larger cities. However, it cannot be said that the public accountant may be of no service to the larger units of government, since his worth along these lines has been repeatedly demonstrated.

As has been stated by writers dealing with this subject, the present literature upon municipal accounting is far from being complete or comprehensive.

Several prominent writers of articles upon municipal accounting published during the past few years have recommended to officials of governmental bodies the services of accountants and safeguards which the employment of public accountants will help to effect.

### PERSONNEL

In the field of municipal auditing a different type of personnel is encountered from that contacted in commercial lines. Many of the officials and employees having to do with the accounts and keeping of records are political appointees or persons elected without having had bookkeeping experience or training in accounting. For this reason, the auditor of municipal accounts is faced with a problem not met to a great extent in handling the accounts of a private business.

This situation calls for much tact upon the part of the auditor, who must constantly strive to improve the conditions as he finds them, but who must realize that he cannot have his recommendations accepted and put into practice as quickly as he might wish. It is also not possible, or we might say the present practice, to discharge municipal employees and officials as promptly as those who are engaged by an individual employer, when it is found that their work is not done as efficiently as it should be. Again, we cannot be all inclusive in these statements for there are employees and officials of municipalities everywhere who are fully appreciative of the trust placed in them and who are carrying out their duties in the best possible manner.

### EDUCATION OF LEGISLATIVE BODIES AND OFFICIALS

The principal problem facing us today is not to effect a realization of the importance of governmental accounting in the opinion of public accountants, or the existing opportunities for service, especially to those who practice in the municipal field, but to stimulate an appreciation in the minds of the leaders and taxpayers of municipalities of the services which the public accountants are capable of rendering.

Greater possibilities in municipal accounting for public accountants in the future are

not apparent unless the trend of legislation indicates that state legislative bodies are recognizing the fact that if professional men may be entrusted with rendering professional services, they can also be trusted to submit proper fees for the services rendered by them. Also, local municipal officials must be educated to have a better conception of the scope of work necessary, and consequent cost, in order to make the audit or investigation of real value to them and to their community.

There are a few instances of favorable legislation which have recognized the advantages to be gained by the employment of public accountants in the audit of municipal records, but the purposes of such laws have been defeated by requirements by the municipality to have bids from the accountants who would undertake the work required by the statute. This is one of the matters which the profession must endeavor to combat at every stage, since competitive bidding results in the end in a gain to neither party. The natural result of competitive bidding is to greatly lower the standards of service by those who accept engagements on this basis, as well as to prohibit reputable firms from doing much, if any, work in the municipal field.

Happily many municipal officials thoroughly appreciate the value of the audit of the accounts of their municipality. Some years ago, J. R. Johnson, treasurer of the City of Birmingham, England, discussed this subject in a lecture entitled "The Function of a Municipal Internal Audit and Its Relationship to the Outside or Professional Audit," as follows:

"In commencing I should refer to the necessity for an audit of Local Authorities' Accounts, but I need not labor this point as I am sure it will be apparent to you all. In the interest of the public it is essential that there should be honesty, economy and sound finance in the transactions of the ratepayers. After the interests of the ratepayers are served there are the interests of the officials themselves. It is much to the advantage of all officials, whether executive, administrative, or advisory, that there should be an independent inspection and approval of their actions, especially when most officials are in positions of public trust. Particularly does this apply to the position of Treasurer or Accountant to a Local Authority. If on no other grounds than safety to himself, the Treasurer should insist upon a complete, continuous and efficient audit. Secondly, he ought to insist on it in order to ensure that there will be true economy, that expenditure and methods conform to standardized systems, and that there is no duplication of expenditure.

"There should be a good coöperation between the professional auditors and those responsible for the internal system in operation. The ideal method to aim at is a continuous internal audit by the treasurer which will be the starting point and the basis of the outside audit."[1]

These remarks by Mr. Johnson should carry additional weight when it is noted that he himself was a municipal official, the treasure of an important English city.

KNOWLEDGE OF ACCOUNTANTS

Public accountants have not been engaged in the capacity of auditors of municipalities to the same extent to which they have served private businesses. This can be attributed, partly, to the inaction of the accountants themselves through lack of knowledge of such accounting and state legislation affecting municipal accounts and finance.

Little consideration has been given to municipal accounting in the examinations by the various state boards for the degree of certified public accountant, with the result that it cannot be said that all certified public accountants are qualified, without extensive special study, to make an examination of local governmental agencies and their various functions. Those accountants who have had such contacts have quickly realized that it is a highly specialized field. Unless the accountant is prepared to master the many intricate problems, it would be far better if such engagements were refused, rather than jeopardize reputation by the improper han-

[1] *The Accountant*, May 17, 1924.

dling of the work. There has been much justifiable criticism of public accountants who are only too willing to accept such assignments at low fees, but who later suffered the dismay of realizing that they had no facilities for properly fulfilling the contract. The whole profession may then be blacklisted so far as that particular community is concerned.

SERVICES BY THE ACCOUNTANT

The accounting service undertaken for a municipality is of a more varied nature than that undertaken for a private enterprise.[2]

The more important services performed by public accountants for counties, cities, townships, towns, boroughs and villages will probably be of interest at this point. This work covers:

Installation of systems of accounts.
Refinancing.
Preparation of budgets.
Installation of systems of budgetary control.
Advising officials of changes in legislation governing financial matters.
Preparation of records for tax sales.
Audits of accounts of officials.
Reports for State Public Utility Commissions.
Reports in connection with CWA loans.
Information for taxpayers' groups.

In the audit of local governmental bodies, the public accountant often is confronted with the examination of various groups under the jurisdiction of the municipality or which may be part of the municipal plan, but operate entirely independent of it. The groups referred to are school boards, sinking funds, sewer commissions, park commissions, poor boards, road commissions, justices of peace, the various utilities such as water, gas and electricity, the courts, etc. The accountant may also be engaged to prepare and file utility reports with the state for government officials, who are usually pleased to delegate this work to him because of his special training.

It is not intended that the above includes all possible work for municipalities.

A word might be said here of the conditions usually found by the public accountant upon the audit of a municipality which had never before engaged the services of an independent public accountant, but which had been audited by a committee of the municipal officials. At best, the municipality was behind the times in adequate accounting procedure. It is regarded as one of the functions of the public accountant in auditing private business to bring to that business the best accounting methods and no less should the public accountant be of service to municipalities in this respect.

One of the more useful and much appreciated services which the accountant is rendering is the preparation of budgets for municipalities and their subdivisions, and in the creation of budgetary control records which enable the municipal officials to constantly have complete and accurate records with respect to budget appropriations and expenditures.

Accountants are often called upon by investment bankers for their certification of the accuracy of the accounts of a municipality before the bankers will attempt to float an issue of securities. On the other side of the picture, the accountant is often called upon by the finance committee of the municipality to draw plans for the financing or refinancing project. The qualifications of the public accountant are being better understood and more universally employed in this connection.

An increasing number of municipal officials realize the advantages of adequate accounting records and it has been the privilege of public accountants recently to install systems of cost finding which, while not involved and which do not entail a great mass of detail records, at the same time are of considerable value in the making of proper assessments and in various other phases of

[2] A list of the services which public accountants have rendered to governmental bodies, and a review of the legislation of the various states of the country affecting the employment of public accountants in the audit of their departments, and the municipalities within their borders, is given in an article published in the *Journal of Accountancy* in March, 1930, prepared by the staff of that magazine.

municipal accounts in which accurate costs should be determined.

Public accountants have been called in upon special occasions when municipal officials found themselves in difficulty upon being confronted by some peculiar problem of municipal finance upon which they felt the need of expert advice. Very often too, accountants have been employed for the first time by a municipality when some evidence of fraud on the part of a municipal official or employee came to light. In this way public accountants have secured a foothold in numerous municipalities which have continued to employ them after the completion of such special work.

It is coming to be realized more and more that the person who in the final analysis pays the bills, that is, the taxpayer, has a right to have the assurance that those to whom they have entrusted the custody of their funds are exercising good faith along with intelligence in the fulfillment of such duties. More and more are public accountants being employed by the direct demand of groups of taxpayers, headed usually by business men who realize that proper records must be kept in any undertaking if it is to be carried on efficiently and that they are responsible to taxpayers to submit financial statements of the municipality which are both accurate and informative.

Fidelity bonding companies have recognized the merit of an audit by an independent public accountant by requesting municipalities bonding their officials to furnish them with a certification from the public accountants. The new Federal Securities Act passed May 27, 1933 requires a corporation issuing securities to furnish a certification of its financial condition by a public accountant. It would be a step in the right direction if municipalities issuing securities were to be subject to this same regulation.

### NATIONAL SOCIETY ENCOURAGES MUNICIPAL ENGAGEMENTS

There has been some agitation recently to have the national organizations of accountants and the various state associations of certified public accountants bring to the attention of municipal officials the qualifications of certified public accountants to undertake an audit of municipal finances. An excellent illustration of the work being done by such bodies is found in the advertisement which was printed upon the inside of the rear cover of the publication "Municipal Finance" for August, 1933, which reads as follows:

> MUNICIPAL AUDITS—
> are required by some charters, are made by committees in some cases and are noticeable by their absence in others. Independent audits are as essential in governmental affairs as in the business and industrial worlds. They lessen the temptation besetting every unaudited employee handling cash or securities. They furnish officials with forward looking suggestions. They
>
> SHOULD BE MADE BY—
> those who have demonstrated their accounting or auditing ability. Auditors should not be chosen on a bid basis, the same as cement is bought. No government unit should buy an audit—it should select and employ an auditor. The auditor's fee should not be looked upon "as sending good money after bad." A well paid auditor will save a city money if his suggestions are followed, the same as a well paid city attorney will save a city trouble if his advice is followed.
>
> CERTIFIED PUBLIC ACCOUNTANTS—
> are registered with a State Board, which issues their certificates and may revoke, cancel or suspend them for cause. Politically appointed auditors are usually dear at any price. The professional standards of any individual may usually best be measured by his attitude toward his professional societies. It is always wise to select auditors from those who are members of the State Society of Certified Public Accountants."

In conclusion, it is desired to emphasize the mutual benefits which can be derived by the municipal officials, taxpayers and the public accountant by making more universal the practice of having independent audits of local government bodies rendered by public accountants. It should also be stressed that the services rendered by public accountants are of very definite and repeatedly proven value to municipal government. Accountants

who seek this type of engagement must be fully prepared to render the specialized services necessary. An excellent indication that accountants are now giving more thought to this particular problem is found in the various accounting journals in which there have lately appeared numerous articles on the auditing of municipal accounts.

Those responsible for the management of government are today being confronted with new and difficult problems which have grown out of the present depression period. In meeting these situations they are depending more upon scientific accounting methods. A recent writer said in support of this viewpoint:[3]

"It is well known in modern business that complete and scientific accounting produces a knowledge of affairs which is a condition precedent to successful management.

"The experiences and revelations of the past twenty years in the conduct of public administration in states and cities of the United States have demonstrated the same thing regarding management of public business. Officers have found that to direct intelligently they need to be fully informed. It is the duty of government, as in industry, to render through its officers, the largest possible service at the most economical cost, particularly since social, welfare and commercial services rendered by states and cities have been becoming more costly each year. The problem of the day, therefore, is increased administrative efficiency."

[3] Harold D. Force in the *Journal of Accountancy* January, 1931: "Evolution of State and Municipal Administration."

# GOVERNMENTAL ACCOUNTING QUESTIONS IN C.P.A. EXAMINATIONS

FAYETTE H. ELWELL

THE SUBJECT assigned was Governmental Accounting and Accountancy Examinations, but I have changed it so that it reads Governmental Accounting Questions in C.P.A. Examinations.

When I accepted the assignment from Professor Morey, I was very enthusiastic as to what I might be able to contribute to this round table discussion. After making a detailed search through all available examinations, I found I had so little material that I am embarrassed in making my report.

The term "governmental accounting" was held to relate solely to the matters relating to systems, budgets, accounts, records, statements, etc. of governmental units. This restriction excluded the questions relating to income tax laws, both federal and state. It further eliminated the general subject of institutional accounts (churches, universities, colleges, hospitals, charitable institutions, etc.).

Wisconsin appears to be the only state requiring a separate examination in Governmental Accounting for the C.P.A. certificate. This has been in effect since the C.P.A. law was passed in that state in 1914.

The Oklahoma statutes regulating the practice of auditing and accounting approved in 1917 provided for a "degree" of Certified Municipal Accountant (as well as the degrees Certified Commercial Accountant and Certified Public Accountant). The portion of Section 6 of that law relating to Certified Municipal Accountants reads as follows:

> The written examination of applicants for the degree of "certified municipal accountant" shall at least cover the four general subjects, with a minimum time allowance, as follows:
>
> (e) theory of accounts, 3 hours; (f) auditing (governmental), 6 hours; (g) revenue and taxation, 3 hours; (h) powers, duties, and compensation of public officials, 3 hours.
>
> The board may add such other subjects as it may deem appropriate and necessary. . . .

I have been able to obtain but one copy of the Oklahoma governmental accounting examinations—that of November, 1933. This examination was divided into two parts, the first part was given over exclusively to fourteen questions on taxes—state and federal income taxes, sales tax, processing tax, gross production tax, etc. The second part contained eleven questions, four of which were on technical governmental accounting subjects, five relating to general questions of governmental administration and one question each on state and federal income taxes.

For some years the state of New Jersey has had a law regulating the auditors of counties and municipalities. A letter from Mr. Walter L. Darby, State Auditor of New Jersey, reads as follows:

> . . . No one is eligible to audit the accounts of counties and municipalities except he holds a license as Registered Municipal Accountant. Such licenses are issued by this office and the applicant must submit to an examination given by this office in order to ascertain his qualifications as a municipal auditor. It is not the policy of this office to give out any copies of examination questions, therefore, none are available.

Surprisingly few questions on governmental accounting were found in available examinations. There has been a growing interest in governmental accounting within the past few years, and when you add the particular emphasis placed upon the subject by Colonel Carter's suggestion to the New York Society of C.P.A.'s last spring and the recent conferences called by the Public Administration Clearing House, we may well expect that far more questions will be asked upon this very important subject. There is no question but that every certified public accountant should be qualified to handle governmental accounting work, and certainly those students whom we are training for professional accounting careers should have had training in at least the fundamental principles of the subject.

Those of us in public accounting practice will readily recall the statements made by governmental officials in the years gone by to the effect that there were so few persons qualified to install and audit the accounts of governmental agencies that the states themselves would have to establish such bureaus. The length to which this has gone will surprise those of you who have not looked into the matter. My hope is that with a new interest in governmental accounting, we may be able not only to train young men for this professional work but that there will be opportunities to have our graduates tested in the various governmental positions in state, county and city. Then we will know more definitely what we should include in our courses and can alter them accordingly.

In my analysis I have divided the governmental questions into two general groups—theory and problems. About twenty-seven per cent of the so-called theory questions relate to the definitions of terms used in governmental units or offices, and from one viewpoint are more concerned with public finance than technical governmental accounting. In other words, I would not include these definitions in my course in governmental accounting; I would assume the students had already studied them in their courses in general economics or public finance.

To illustrate the comparatively elementary character of the majority of the theory questions which have been asked the following may be used:

"The town of X erects a school building from the proceeds of bonds issued for the purpose. The building is estimated to last twenty years. The bonds also mature in twenty years, and contain a sinking-fund clause to provide the funds for their payment at maturity. The school board makes no provision for depreciation on the building in the annual tax rate, and a controversy arises in the town as to whether or not such provision should be made. Discuss briefly both sides of this question."

This question has been asked many times in different examinations—the asset referred to being a school, water plant, city hall, incinerator, etc.

In the analysis which I have made the two questions which have been repeated in the Institute examinations are counted as two questions, (not four). They are as follows:

"Name and describe the principal groups in which the financial transactions of a municipality should be summarized in its annual statement." (Institute, Nov. 1921 and May, 1931.)

"In auditing the annual report of the Town of X you find all the following items of receipts stated under the general head of 'Revenues':

1. Taxes received
2. Loan from Bank of X
3. Dog licenses
4. Municipal court fines
5. Bequest from the estate of A to establish town library
6. Street assessments collected from owners of abutting property
7. Permits for parades
8. Sale of worn-out equipment
9. Transfer of balance from street opening to street cleaning account
10. Deposit by B to cover cost of extra sewer connection
11. Interest on bank deposits
12. Donation from C toward repairs on his street
13. Annual payment under franchise by X Street Railway Co.
14. Fees from town clerk turned in
15. Rent of city dock to steamboat company
16. Assessments on members of police force for pension fund
17. Received from B balance of cost of extra sewer connection (see 10)
18. News stand privilege in city hall
19. Proceeds of paving bonds sold at 110
20. State grant for upkeep of state highway within town limits.

Restate these items to show true revenues of the town with titles of proper accounts to be credited; and indicate how the other items should be shown or treated." (Institute, Nov. 1922 and May, 1933.)

(Perhaps this is an illustration of the statement made on page 267 of Facts and Purposes "In the preparation of examinations the Board exercises a peculiar thoroughness.")

About thirty-nine (39) per cent of the governmental accounting theory questions have been on the definitions of general governmental accounting terms or distinctions between such terms; approximately twenty-four (24) per cent of the theory questions have related to budgets and appropriations, and about ten (10) per cent to the classification of governmental accounts.

(In several cases the so-called "theory" questions were included in The Theory and Practice of Accounting and Auditing Examinations.)

There are a number of miscellaneous subjects covered by questions which are neither theory or problems such as designing of forms and statistical charts or graphs.

An analysis of the problems which have been given in the various C.P.A. examinations shows that the great majority of them have been related to the preparation of statements (fund balance sheets, divisional balance sheets, consolidated balance sheets and operating statements). About eighteen such problems were found, the majority of which were very good.

Among the other subjects covered by the problems examined are the following:

- Determination of the amount of tax levies for states, counties and cities.
- Reconciliation of controller's and treasurer's cash balances.
- Shortages in treasurer's office.
- Preparation of data in connection with bond issues
  - What is lowest bid?
  - Interest tables
  - Comparison with tax levy
  - Calculation of sinking funds
- Departmental cost data
  - Water Department
  - Gas Plant
- Entries and accounts for various types of transactions, such as
  - Improvement projects
  - Trust Funds
- Analysis of sundry accounts

In all, forty problems were found which might be used as laboratory material. Granting that my analysis did not include all examinations, it would seem that instructors have comparatively little laboratory material available from this source. In this connection it might be suggested that the better questions on governmental accounting be published, but my reply to this anticipated suggestion is that there would be such a small sale for the manual (with only ten collegiate schools having such a course) that one could not afford to tie up his money in the project. Then, too, there undoubtedly will be an increased number of questions asked on this subject in the examinations of the next few years with new problem material thus being made available. The excellent questions included in the recent Pennsylvania, Virginia and American Society examinations illustrate my point.

Is it proper to suggest that those instructors who have access to complete files of examination questions in various states should make an analysis of all questions on governmental accounting so that it may be available for general use? (For example, Professor George Bennett of Syracuse University, now Chairman of the New York State C.P.A. Board, might have such an analysis made of all the New York examinations. I cannot imagine any objection to this analysis being made available to the accounting instructor for use in organizing his courses.)

In summary it would appear that throughout the country there have been very few governmental questions given in C.P.A. examinations. With the very pronounced interest in the subject at the present time, it is very likely that the number of questions set in this field will increase and accounting instructors may well prepare their accounting majors accordingly.

# DOCUMENTATION IN ACCOUNTING LITERATURE

Arthur H. Winakor and Daniel Borth

It is commonly recognized that there are certain standards[1] of presenting mature and carefully written scientific literature.[2] These standards pervade all bodies of thought and learning, and they provide one basis of appraising and criticizing the major contributions and of placing them in a proper historical perspective. When, therefore, while conducting a review of several accounting books, a marked departure from these standards was encountered, the authors were inclined to examine the matter in more detail. The difference between these accounting books, in their use of references, and the books in other fields with which the writers were familiar, aroused questions as to why there should be such obvious variations. This led to an examination of the grounds upon which the use of citations, references, bibliographical notes, and the like, are justified.

It is the intention of the writers to present the results of a factual survey of accounting books, and to appraise accountancy in the light of the failure of writers in this field to provide in their important contributions the valuable continuity of thought and references generally found elsewhere. For comparative purposes, it has seemed wise to make a similar study of books in the field of economics.

In order to acquaint the reader with some of the fundamental problems invoked by this investigation, the following questions are propounded so that he may approach with a critical attitude the facts set forth for his consideration at a later point. For example, are the expressed ideas, policies, assumptions, and procedures of accounting matters of more "common knowledge" to the students of that science than those of economics, political science, sociology, law, and history? Are the methods, concepts, and thoughts advanced by the typical text book writer in accountancy matters of more "common knowledge" in the science, and/or more original with the author than might be expected in other fields of organized thought? The readers' answers to these questions will largely determine whether accounting writers are to be condoned or criticized.

As an aid to the interpretation of the factual results of this investigation, a review of certain ideas and principles of manuscript preparation as set forth by those authoritative in that field, is presented at this point. Since the study largely revolves about the use of footnotes and references, it will be well to give some thought to their purpose and function. It has been indicated by Spahr and Swenson, and corroborated by others, that the functions and purposes of footnotes are substantially as follows:[3]

1. To present supulementary information not directly pertinent to the purpose of the text.
2. To furnish "bibliographical aid to the reader."
3. To indicate the authorities upon which the work is based.
4. To provide a basis upon which the reader may "judge the reliability" of the ideas presented.
5. To "call attention to additional supporting sources."
6. To acknowledge and call to the reader's attention the existence of contrary and variant thought.
7. To connect and coördinate the different parts of the text.
8. An additional and somewhat neglected func-

[1] "Code of Ethics for Scientific Men," *Science*, Vol. 66: 103–4, July 29, 1927; Paull, H. M., *Literary Ethics*, Thomas Butterworth 1928. 452 p.; Goudy, Henry, "Plagiarism a Fine Art," *Juridical Review* (1908) Vol. XX, No. 3, p. 302; Spahr, W. E. and Swenson, R. J., *Methods and Status of Scientific Research*, pp. 328–333. Harper & Bros., 1930.

[2] In the use of the word "science" in this article, as applied to accounting, the writers are employing the word in a rather general manner, and do not wish to enter into the "science vs. art" controversy.

[3] Spahr, W. E. and Swenson, R. J., *op. cit.*, p. 285. Schluter, *How to Do Research Work*, Prentice-Hall, 1929, pp. 121, 125. Kelley, T. L., *Scientific Method*, Ohio State University Press, 1929, pp. 43–80, especially. Good, C. V., *How to Do Research in Education*, Warwick & York, 1928, p. 213.

> tion of footnotes, especially in treatises designed to fill an authoritative niche in scientific literature, is to provide continuity of scientific thought, and indicate and recognize the position of the contribution in the literature of the science.[4]

It is not possible to enter into a discussion of these simply enumerated statements. Further thought, however, may add to the clearness of their proper functions. The use of footnotes and references does not of itself give weightiness or authority to a book which otherwise lacks real merit; certainly it is not intended that they (the footnotes) should be used as padding or camouflage. Books which are a mere piecing together of assembled scraps are more discernible to the reader if the sources are adequately indicated. Footnotes and references serve a real purpose, and perform certain functions which cannot otherwise be adequately or satisfactorily incorporated in the book. Much more than a table of contents, or much more than an index, the footnotes and references should be part of the book, and not addenda tacked on here and there.

While the footnotes and references provide an outlet for certain more or less incidental and ancillary thoughts, which would not ordinarily be placed in the text, they likewise serve some other very essential functions. To the young student, to the novice and to the casual reader from other fields, they make it possible to have handy references to sources to which they may go for additional reading along the same or similar lines. To the more advanced student they serve the purpose of enabling him to judge the merit of the book, in addition to serving the above assistance. They provide an excellent outlet for criticism and appraisal of contrary thought; they likewise make it possible to recognize such thought, protecting the writer from the criticism that he has failed to see this or that or to consider certain works.

Since the writer is presumed to be more familiar with his own ideas, and better able to direct the thoughts and energies of serious readers, it is through this avenue that he can provide this noteworthy service. In innumerable other ways they make it possible for him to provide a continuous, homogeneous text, and yet to present those side thoughts and comments which may frequently be as important as the text itself.

Quite obviously there is no obligation on the part of an author to employ certain types of footnotes. For example, the writer may not need to incorporate cross reference footnotes. On the other hand, he should not neglect the duty to recognize through references those sources original with other scholars.[5]

In general what obligation does a writer have to those who have preceded him and to those who are contemporary with him? Spahr and Swenson have expressed their idea tersely as follows: "Every important statement of fact in the text should have a footnote indicating source of information, unless it is of common knowledge or unless it is primary with the writer. Some none too modest persons regard themselves as the final authorities and so do not document their writings; but even recognized authorities are not licensed to appropriate the ideas and labors of others without appropriate acknowledgement of such indebtedness."[6]

A survey was made of 50 accounting books, and for comparative purposes, of 25 economics books,[7] to determine factually and ac-

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[4] For a somewhat similar view, see Whitney, F. L., *Methods of Educational Research*, pp. 136–7. D. Appleton & Co., 1931.

[5] Bogardus, E. S., *Making Social Science Studies*, 3d. ed., p. 96. Jesse Ray Miller, Los Angeles.

[6] Spahr and Swenson, *op. cit.*, p. 285, see also p. 332. Kelley, *op. cit.*, p. 66; Good, *op. cit.*, p. 213.

[7] It is not the intention of the writers, in the selection of the 25 books in economics, to make any careful direct comparisons between the 50 accounting and 25 economics books, but merely to have enough of a sample to indicate the merit of their contentions, and to obviate the criticism that we had failed to look into the literature of other fields. We have not sought to select all the outstanding books but merely to select a representative group. Any omissions should be, therefore, viewed in the light of that limitation. It is the opinion of the writers that the list selected for accounting books is far better and more favorable sample of accounting literature than the 25 books are of the economic literature.

Undoubtedly the more scientific method of comparison would have been to select typical books from many different fields of scientific writing. The writers chose economics including the field of finance, because they felt that it was more closely related to accounting. Some

curately the extent to which the authors employ references of various kinds.[8] Included among these books were many of the generally accepted authoritative treatises which the writers believe represent a fair sample of the literature.[9]

For each book, a computation was made of (1) total pages, (2) total footnotes of all types, (3) footnotes referring to other treatises, that is "alien" to the writer, (4) bibliographical references at the end of chapters or end of the books, and (5) acknowledgments in the preface to specific works other than casual reference.[10] From these data it

consideration was given to the selection of books in the field of law, but the tediousness of the task, as well as the undoubted results discouraged this pursuit.

[8] We realize that such problems cannot be answered in simple categorical fashion nor do we attempt to do so. It is possible, however, to throw considerable light on the subject under discussion without attempting to reduce it to its lowest terms.

[9] The books surveyed were:

List of 50 Accounting Books

Bell, W. H., Accountants' Reports
Bell, W. H., and Powelson, J. A., Auditing
Bennett, G. E., Corporation Accounting
Bennett, G. E., Accounting Systems
Bliss, J. H., Financial and Operating Ratios in Management
Castenholz, J. B., Auditing Procedure
Castenholz, J. B., Solution to the Appreciation Problem
Cole, W. M., Fundamentals of Accounting
Couchman, E. C., The Balance Sheet
Dicksee, L. R., Advanced Accounting
Dohr, J. L., Cost Accounting
Eggleston, D. C., Modern Accounting Theory and Practice, II.
Eggleston, D. C., Auditing Procedure
Esquerre, P. J., The Applied Theory of Accounts
Finney, H. A., Principles of Accounting, II.
Gilman, S., Analyzing Financial Statements
Goggin, W. J., and Toner, J. V., Accounting Principles and Procedure
Gordon, W. D., and Lockwood, J., Modern Accounting Systems
Guthman, H. G., Analysis of Financial Statements
Hatfield, H. R., Accounting
Hayes, M. V., Accounting for Executive Control
Jackson, H., Audit Working Papers
Jordan, J. P., and Harris, G. L., Cost Accounting
Kester, R. B., Accounting Theory and Practice, II.
Klein, J. J., Elements of Accounting
Kohler, E. L., and Pettengill, P. W., Principles of Auditing
Krebs, W. S., Outlines of Accounting, II.
Lawrence, W. B., Cost Accounting
McKinney, J. O., Managerial Accounting
McKinsey, J. O., Budgetary Control
Montgomery, R. H., Auditing
Morey, L., Manual of Municipal Accounting
Paton, W. A., Accounting Theory
Paton, W. A., Accountancy
Rorem, C. R., Accounting Methods
Rosenkampff, A. H., Bookkeeping Theory and Practice
Saliers, E. A., Depreciation
Sanford, E. R., Applied Accounting Principles
Schlatter, C. F., Elementary Cost Accounting
Scott, D. R., Cultural Significance of Accounts
Scovell, C. H., Cost Accounting and Burden Application
Scovell, C. H., Interest as a Cost
Scovill, H. T., Elementary Accounting, II.
Sells, E. W., The Natural Business Year.
Sprague, The Philosophy of Accounts
Stockwell, H. G., How to Read a Financial Statement
Taylor, J. B., and Miller, H. C., Intermediate Accounting, I.
Thompson, W. R., Accounting Systems
Wildman, J. R., and Powell, W., Capital Stock without Par Value
Wildman, J. R., Principles of Cost Accounting

List of 25 Economics Books

Badger, R. E., Investment Principles and Practices
Bogart, E. L., Economic History
Dewing, A. S., Financial Policies of Corporations
Edie, L. D., Economic Principles and Problems
Edwards, G. W., International Trade and Finance
Ely, R. T., Outlines of Economics (1926)
Fairchild, F. R., Furness, E. S., and Buck, N. S., Elementary Economics, I.
Fisher, Irving, The Purchasing Power of Money
Gerstenberg, C. W., Financial Organization and Management
Glaeser, M. G., Outlines of Public Utility Economics
Jones, E., and Bigham, T. C., Principles of Public Utilities
Haney, L. H., Business Organization and Combinations
Kilbourne, R. D., Principles of Money and Banking
Lincoln, E. E., Applied Business Finance
Lutz, H. L., Public Finance
Lyon, H., Corporation Finance
Lyon, Hastings, Investment
Mead, E. S., Corporation Finance
Mills, F. C., Statistical Methods
Rockey, R. G., The Banking Process
Rufener, L. A., Principles of Economics
Schultz, W. J., American Public Finance and Taxation
Snyder, C., Business Cycles and Business Measurements
Taussig, F., Principles of Economics (1924) Vol. II.
Watkins, G., Labor Problems.

[10] With these data at hand for each book, the bibliographical reference at the end of chapters or end of the book and specific references in the preface were added to the total footnotes. The sum of the footnotes and references thus obtained, was divided into the total pages of *text* to obtain the number of pages per footnote and reference. A second calculation was made employing the more severe standard—footnotes referring to other treatises, namely those referring to outside sources, etc.

References within the text matter of the books are not included in any of these groups. Such references, however, we believe would not be important in the final results.

In the tables and factual data, the results are presented as "pages per footnote" instead of "footnotes per page." Although the latter seems more logical it would have involved clumsy fractions, such as "$\frac{1}{4}$ footnote per page, etc."

was possible to ascertain the number of pages of text for all footnotes and also for "alien" footnotes, that is footnotes referring to sources, comments of other authors, and the like.

The significance of this table may be readily grasped by noting two outstanding groups of books in both accounting and economics. Twelve accounting books, or 24 per cent of the 50 surveyed, had an average of less than 5 pages per footnote and reference, or in other words, had at least one footnote and reference for each five pages of text. In contrast, there were 21 out of 25 economics books or 84 per cent, which had at least one footnote for every five pages of text. At the opposite extreme were 14 accounting books or 28 per cent of the total which had not a single footnote or reference of any kind, whereas, not a single one of the 25 economics books had such a poor showing.[11]

On the stricter classification of what has been called "alien" footnotes, it was found that only 5 of the accounting books or 10 per cent had at least one footnote referring to outside sources for every five pages of text, compared with 13 or 52 per cent of the economics books. On this same classification 50 per cent of the accounting books did not contain any footnotes which directed attention to outside sources, but none of the economics books had such a record.

One might be prone at first thought to justify such data, with their reflection upon accounting books, on the ground that certain types of books, e.g., elementary[12] books, do not need documentation. But the same thought applies to the economics books as well as to the accounting books, and since there was a greater proportion of elementary books in the economics list than in the accounting list, this explanation does not appear feasible.

Only 8 out of the 50 accounting books, could be classified as strictly elementary. Of the 42 advanced accounting books, 18 or 43 per cent had no "alien" footnotes. It would seem that one would have to search far in other sciences to find such a large percentage of undocumented advanced books.[13] The record of the elementary accounting texts is even less favorable, for only 1 out of the 8 had any "alien" footnotes at all.[14] There

TABLE I

DISTRIBUTION OF 50 ACCOUNTING BOOKS AND 25 ECONOMICS BOOKS ON THE BASIS OF NUMBER OF PAGES PER FOOTNOTE AND REFERENCE

| Number of Pages per Footnote and Reference | Number of Accounting Books on basis of: | | Number of Economics Books on basis of: | |
|---|---|---|---|---|
| | Total Footnotes and References | "Alien" Footnotes | Total Footnotes and References | "Alien" Footnotes |
| Total Books | 50 | 50 | 25 | 25 |
| 0– 4.9 | 12 | 5 | 21 | 13 |
| 5– 24.9 | 8 | 10 | 3 | 8 |
| 25– 99.9 | 9 | 6 | 0 | 3 |
| 100–600. | 7 | 7 | 1 | 1 |
| No footnotes | 14 | 25 | 0 | 0 |

[11] The far better showing of the economics books may be easily shown in another way. The 25 economics books had 16,260 pages of text and 13,676 footnotes, references and the like, or one footnote and reference for each 1.2 pages. The 50 accounting books had 21,079 pages of text, 4,091 references and footnotes of all kinds, or an average of one for each 5.2 pages of text.

[12] It is recognized that elementary and like terms are relative and that someone else might well have made a somewhat different classification. The writers, however, believe that changes in the classification of particular books would have no material bearing on the results.

[13] It is realized, of course, that there are exceptions in all fields, but it is doubtful whether in general, such a dearth of references could be found elsewhere.

[14] The writers do not wich to leave the impression that it is their opinion that a dearth of references in an elementary treatise can be justified either by the simplicity of the contents or by the very common "one method approach" which is found in accountancy texts. There is a justifiable difference in the need for notes and references in elementary texts and advanced treatises, but these involve the nature of the footnotes and not the question of whether there should or should not be such

were six elementary economics books in the list of 25, of which 2 had at least one footnote for each 5 pages, 3 more had at least one footnote or more for each 15 pages and the sixth of which had one footnote or more for each 50 pages.[15] The much more favorable showing of economics books is apparent, either on the basis of elementary or advanced texts. One may well wonder whether accountancy is such a youthful field[16] of knowledge that preponderance of ideas and procedures are unique with the authors of books.

A further classification of the 42 accounting books which could be considered as "alien" footnotes, 4 out of 7 in Cost Accounting, and in Auditing, and 2 out of 4 in Theory, and in Interpretation, had no outside references in the text proper. For the 42 books there were only 5 of which had 1 or more outside footnote references per each five pages.

Surprising as it may seem, what is frequently conceded to be one of the outstanding books in the theory and practice of accounting had only 2 "alien" or outside footnotes in the entire book. Books, such as most of those tabulated above, particularly those in the fields of Advanced Theory, Cost Accounting, Auditing, and Interpretation, are

TABLE II

DISTRIBUTION OF 42 ADVANCED ACCOUNTING BOOKS ON THE BASIS OF NUMBER OF PAGES PER "ALIEN" (OUTSIDE) FOOTNOTE

| Number of Pages per "Alien" Footnote | Advanced Theory and Practice | Cost | Auditing | Theory | Interpretation | Miscellaneous | Total |
|---|---|---|---|---|---|---|---|
| Total Books | 10 | 7 | 7 | 4 | 4 | 10 | 42 |
| 0– 4.9 | 1 | 0 | 0 | 1 | 1 | 2 | 5 |
| 5– 24.9 | 3 | 1 | 2 | 1 | 0 | 2 | 9 |
| 25– 99.9 | 1 | 2 | 0 | 0 | 1 | 2 | 6 |
| 100–600. | 2 | 0 | 1 | 0 | 0 | 1 | 4 |
| No footnotes | 3 | 4 | 4 | 2 | 2 | 3 | 18 |

being advanced produced the following results:[17]

The books in the above table are for the most part advanced and specialized books in which it would hardly be expected that a single individual could propound on his own behalf each and every idea, or that each and every idea was common knowledge. Nevertheless, 3 books out of 10 in the group of Advanced Theory and Practice had no intimately related and interwoven with the fields of banking and corporation finance, engineering and economic valuation, general economic theory and business practices, and legal and social problems. Nevertheless, there is an almost complete failure on the part of most of these books to recognize or even suggest such interrelationships of problems and purposes. In other words, most of the accounting books are confined within their single narrow field, and apparently the authors do not see the necessity for looking beyond the horizons of accounting when writing their books.

Among the "miscellaneous" books in the above table, which embraced books in the fields of budgeting, systems, municipal accounting, and valuation principles, by far the worst showing was made by the books on accounting systems. Although their authors would justifiably deny it the implication may be made that each thought that his sys-

references. References for reading, sources, other methods, and comments thereon belong in an elementary text, just as in the advanced text.

[15] It should be further pointed out that the economics books showed their superiority in the use of references in another manner. As a whole they had more complete and more frequent use of bibliographies. both at the ends of chapters and at the end of the books.

[16] Littleton, A. C., *Accounting Evolution to 1900*, American Institute Publishing Company, N. Y., 1933.

[17] No further data on economics books are introduced, since they do not change the results and statement which are made, and because they have already served their purpose in giving a rough basis of comparison. The study is essentially concerned with accounting and not with economics or other fields.

tems were unique, or that he did not realize that there might be others, or that he felt the student need not know that there were others.

Additional classifications of the data (which are not presented in the tables) showed that 15 out of the 29 accounting books which had been written primarily as text books had no alien footnotes, while 7 out of 11 books probably intended primarily for practitioners had no outside footnotes.

A selection of the accounting books which were written primarily as texts for teaching purposes showed that 16 were works of strictly academic authors and 13 were works of men who were both practitioners and teachers. Seven of the 16 books written by strictly academic men had no outside references, and 8 out of the 13 written by authors who were both practitioners and teachers had no outside references. The showing of the academic writer is not materially better than that of the academic-practitioner.

Of the 50 books, 11 were written essentially for practicing accountants. Seven of the 11 had no outside footnotes; 6 of these 7 were written by professional accountants. One might question whether the responsibility of the academic writer for the employment of source references is greater than that of the practicing accountant. Since the book written by the practitioner is quite likely to be used in academic class work, since junior accountants working under him, or for his firm, invariably look upon such books as authoritative guides, and especially, since he undoubtedly consults other sources, his debt to others should be duly acknowledged. This would seem to be a justifiable criticism to make since most of the writings of practicing accountants deal with advanced and specialized problems.

The factual data presented here have in the writers' opinions been conservatively stated, and the implications and inferences which are made do not appear unreasonable. There were some outstanding books which showed a high standard of scientific character. A few of them had excellent bibliographies. In some other books which appeared to have a copious usage of references, however, there was a preponderance of legal citations almost to the exclusion of references to other accounting authorities, professional bulletins and magazines, or other allied fields of thought.

Some who have pre-viewed this study have felt that accountancy may be likened to mathematics, and thereupon based their justification for the unfavorable showing of accounting writers. The present writers feel that those who make this contention tend to see a definiteness in accountancy far exceeding actuality. In fact, it is maintained that until accountants and accounting students see their science in its true perspective of interrelationship with corporation and public finance, engineering, economic and monetary theory, legal and social control, accountancy will never attain its rightful position as a useful tool in economic life. Accounting authorities are prone to state only one method or procedure and leave the students with the impression of rigidity and certainty which is not true to fact. Nothing could be more fatal to the progress of accountancy.

The failure of accounting books and writers to enlist the assistance of other writers, both in their own and related fields, as indicated by their failure to employ references and citations, is merely one aspect bearing out this critique of accounting.[18]

Accounting writers in failing properly to document their writings have neglected to assume their full responsibility, which is much greater than its surface implications. It is submitted that this meagre consultation with other minds, as evidenced by the dearth of footnotes and references, leads to an inbreeding of ideas and practices, tending toward an unnecessary narrowing of the viewpoint of the student of accountancy, which will perpetuate an even more unsatisfactory state of the science. Certainly, the absence of footnotes and the inadequate recognition of the work of others quite likely leads to disparagement of the pioneers in the field

[18] By way of suggesting others, one need only to refer to the many illogical procedures and practices, combinations of conservatism and expediency, influences of purpose and uses on results, and the like.

and to the discouragement of future writers.[19]

Even if writers in accounting subjects consider the value of footnotes and references from their own viewpoint alone, it cannot be doubted that footnotes and bibliographical references make a book a valuable and lasting source of citations and cross references which may, in many cases, outlive the usefulness of the treatise itself. Qualified authorities in other fields have often stated that the addition of proper footnotes and references lends weight to a book and makes it even more commanding than before. It is difficult to believe that authors of accounting books have labored under the delusion, long exploded in other fields, that the addition of such citations belittles or detracts from the authoritativeness of the particular text or author.[20]

A determined reversal of the present methods pursued by the writers of accounting in this regard would do much toward raising the standards of accounting literature. Such adoption of a scientific method in the preparation[21] and composition of accounting treatises would eventually lead to the growth of accounting works as authorities readily accepted and quoted in related fields of thought and add prestige to the profession.

This investigation, it seems, is a challenge to those contemplating written projects to weigh more seriously their individual responsibilities not only to the science, but also to those whose ideas, because of priority and importance, merit acknowledgment. The progress of any body of organized thought depends upon the accumulation and intertwining of knowledge and the documenting of sources to aid in the advancement and enlargment of thought. If accounting is to develop commensurately with other sciences, it must not repeat the errors of the past; it must learn from the experience of other fields.[22]

In view of the deficiences of many accounting works, as indicated, it would seem that the teacher should recognize these weaknesses and definitely supplement his work with presentations pointing toward scientific standards—to initiate the student into the mysteries of a dynamic rather than a static science. Certainly if these factual interpretations and conclusions are justified, the defenders of present methods in the preparation of accounting books owe many explanations to those interested in the progress of accountancy as a science.

Nor does it seem an adequate defense of the old methods for their writers of accounting books to maintain that they are presenting one (their) method in order not to confuse the reader or student, as the case may be. Confusion does not necessarily arise from a knowledge of (or lack of knowledge of) methods, but from a lack of understanding of principles. In elementary books, it is possible to mention other methods in footnotes; in advanced texts, the controversial problems may well be placed in the text. The failure to inform students of varying methods, frequently leaves them helpless when confronted with them, either in class problems or practical accounting.

There may be some circumstances which can be advanced by accountants in partial or full mitigation of these shortcomings. In general, they do not appear valid to the writers. It may be argued that many of the teachers of accounting have been drawn from the ranks of professional accountants. Many of these men would likely lack the scholarly attitude which would be expected from those with the purer academic background and training. This may account for their shortcomings, but it hardly justifies them. Contrariwise, many of the practi-

[19] A freer and more willing use of references would possibly have avoided some of the doubtful authorship controversies. For illustrations of similar problems in another field see, Stiles, C. W., "Absent Mindedness as a Factor in Professional Ethics," *Science*, Vol. 71, pp. 100–101. Jan. 24, 1930. W. D. Mathews denies the necessity to award pioneers by giving credit. See "Credit and Responsibility in Scientific Publications," *Science*, Vol. 71, 662–3, June 27, 1930.

[20] Spahr and Swenson, *op. cit.*, pp. 285, 328–333.

[21] Sometimes the failure to give adequate credit is undoubtedly due to carlessness in note-taking during the preparation of the treatise. On the general principles of note taking, see Dow, E. W., *Principles of a Note System for Historical Studies*. Pp. 21–41, Century Co. 1924.; Spahr W. E. and Swenson, R. J., *op. cit.*, pp. 145–148.

[22] Whitney, F. L., *op. cit.*, especially pp. 136–137.

tioner-authors have come from the school of "hard knocks" and likewise lack academic training. The same arguments hold here.[23]

Publishers of books are frequently prone to look upon footnotes as added and unnecessary expense. But this can be no more true of books in the field of accounting than in the many other fields of thought. Furthermore, it may be stated that no writer would permit a publisher to delete from his treatise those thoughts which he felt were essential thereto; by the same argument he should refuse to permit the publisher to omit footnotes and references if they are material to his contribution. Publications in other fields have survived the desires of publishers to economize; accounting can do the same if writers see the merit of references and insist on them.

In the long run, and for its own best welfare, accounting cannot be judged in the light of its limiting circumstances such as enumerated above. It must be judged in the light of its true possible social value and its position relative to other sciences. If accounting writers are not prepared to uphold the standards ordinarily exacted in other fields, it is accounting that must suffer by comparison. Accounting must in the long run conform to the best available standards no matter where they are found. The weaknesses whch may be found in certain other fields of thought cannot be used as an umbrella to protect accounting writers and their literature. Weakness in one science does not warrant the same in another.

[23] Some, who are more critical, may contend that when a practitioner enters the teaching field, or writes books for use therein, he may justifiably be held to academic standards.

# SOCIALIZED ACCOUNTS (II)

A. C. Littleton

In the prior instalment[1] it was pointed out that during the first phase of the development of accountancy (i.e., while double entry was being formed and later expanded into accountancy) accounting data were strictly private as was to be expected in an age of individualism. The use of accounts as an aid to social control had not at that time been developed. But the unsocial results of the bubble period of stock promotions and the unbelievable orgies of speculation in eighteenth century England brought into bold relief the right of society to protection against the rampant individualism of unchecked self-interest. When later an approach was made to a control over private affairs in the social interest it was through the enforced sharing with the public of what formerly had been private business data. This beginning in what may be called socialized accounts characterized the second phase of the long evolution of accountancy.

The British were the first to face the problem of finding a way to control unsocial individualism without resorting to absolute prohibitions. Early in the nineteenth century the government was under pressure to relax the prohibition of company promotion which dated from 1720 and to make the incorporation of joint stock companies somewhat easier. But the thought of simple repeal of the Bubble Act brought visions of another disastrous era of unrestrained stock-jobbing and wild speculation. The problem was to find a way to yield to the pressure for free incorporation without opening the way for former excesses. The answer was found in breaking the privacy of accounting information. Through the operation of the Company Acts the public was to be protected from fraudulent promotions by government-enforced publicity (company registration) regarding the people who were proposing the company, the capital to be subscribed, the uses to which the assets were to be put, and the like. Absentee investors (shareholders) were to be protected from fraudulent directors by the enforced keeping of accounts and the compulsory examination of the directors' accounts by representatives of the shareholders.

This was the British approach in the early nineteenth century to a control over private business affairs through semi-public accounts. Attempts at control in the United States came later and seem in comparison rather unorganized. We have had nothing quite as effective as the British registration of proposed incorporations. The data required by the individual states for permission to incorporate have been varied, inadequate and little used. In fact incorporation statutes have had to be supplemented in many states since 1911 by so-called "blue sky laws" which require additional publicity of financial data for new issues of securities. The recent Federal Securities Act is in the same category. But these security laws have not been tied-in with the laws of incorporation. No more have we had any thoroughgoing attempt to require adequate accounts or periodic examinations. Uniform accounts have been required of railroads since the '80's and more recently the states have prescribed accounts and statements for public utilities. There are scattered cases, also, in which a periodic examination of the accounts is required—for example, bank examinations, income tax audits, the audited balance sheets sometimes asked by banks supporting a line of credit or an underwritten issue of securities, and recently the audits required by rule of commodity and security exchanges.

But our attempts at protecting the public against possible excesses in business individualism have made only an unorganized use of accounts, and many Americans now question the adequacy and reality of that type of protection. They see that such uniform accounts as we possess have not fore-

[1] In the December, 1933, Accounting Review.

stalled wasteful over-capacitation of productive plants, or revealed the financial juggling of holding companies, or prevented the suffocation of the railroads. Such periodic audits as have been made have not turned the light clearly upon the activities of bank affiliates, tax audits have not broken up tax evasion, certified balance sheets have not precluded overborrowing. The Federal Securities Act is a plain recognition of the inadequacy of the state blue sky laws; the security exchange requirement of certified statements suggests that statements furnished banks for short term credit are insufficient when long term capital is involved.

While it is true that dissatisfaction is being voiced in this country regarding the adequacy of the control which rests upon a partial sharing of business and accounting data, yet few indeed would advocate a return to wholly private accounts and the abandonment of all regulation. Rather the discussion now tends toward another alternative, namely, increased governmental regulation (perhaps finally to lead to a species of governmental ownership) or enlightened self-management of business accompanied by a larger regard for the public interest.

The probable next step to be taken is not hard to deduce. Because there is in this country a widespread distrust of government (politics) in business, one would expect public opinion to support increased governmental regulation or governmental ownership only as a temporary measure or as a last resort. A trial acceptance of some sort of Industrial Democracy, Economic Planning, or Business Self-government would therefore seem the most logical ultimate development to expect. If business should prove capable of effecting a trustworthy organization which would unselfishly steady prices to the consumer, smooth out the return to investors, and assure regular employment to workers, such a plan would seem to be a satisfactory solution of the dilemma now facing society.[2] Instead of either the old *laissez faire* individualism of unrestricted competition or an extended regulation of business by bureaucratic divisions of a political government, a trial of private, coördinated enterprise in the attempt to regulate itself in the general interest seems to offer the most acceptable approach to the problem.

If such an evolution should take place, accountancy would have to play a much more prominent part than has been the case either under a regime of fully private accounts or one of semipublic accounts for selected industries.

The second or regulative phase of accounting's development shows that the trend is already toward the substitution of account-data for unrestricted competition as a means of securing economic justice for the various elements of society.[3] The best illustration of this trend is the use of data instead of competition in establishing the rates charged by railroad and the prices charged for utility company services. If the evolution of conscious control continues, control must still be based upon facts; indeed there must be a far greater dependence than at present upon the adequacy, the appropriateness and the reliability of the data used. If the data have these characteristics in good measure, then coördinated private enterprise may safely lay far-reaching plans upon them as the foundation. If the data are unsound, the plans are almost sure to be untrustworthy.

The larger part played by accountancy in supplying adequate, appropriate and reliable data for use in Business Self-government would constitute the third phase of accountancy's development. The period during which this expansion was taking place would reveal an enlarged social consciousness on the part of both capital and labor, and a full sharing of accounting data in place of the partial sharing which was characteristic of the second phase.

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[2] "A great corporation is not a private business, like a farm or a small store or the kind of factory where the owner is the manager. It is in some measure a public institution: occupying so large a position in its own labor market, its wage policy is affected with the public interest; occupying so large a part in the commodity market, its price policy is of public concern; since its capital is publicly subscribed, its financial management is a public trust." Walter Lippmann.

[3] This is the theme of Prof. DR Scott's book, *The Cultural Significance of Accounts.* (Holt, 1931.)

If the next change in our economic institutions is to take the form of some sort of organized Business Self-government, it will be of considerable interest now to note some of its expected characteristics. The late Professor W. C. Schluter paints an interesting picture of the way Business Self-government might be organized.[4] It is not without interest to accountants.

Business self-government would mean the relinquishment of direct control over business by bureaus or individuals connected with political government, and in its place the organization by business—capital and labor together—of its own organs of self government.

A good picture of such a "Business Government" would show capital and labor in individual enterprises electing representatives of formulate agreements about their mutual problems. It would show these representatives for all the enterprises in one industry uniting to select representatives for that industry who would discuss, with similar representatives for other industries, such problems of business operation and control as were mutual to the related industries. At the top would stand a body to which unsettled questions could be referred—a body of representatives of both capital and labor elected in the same democratic American way and accorded the same understanding support (when deserved) that is accorded political representatives.

Political government would "sit in" with the elected representatives in order to join the voice of the general public with capital and labor, but without thought of dominating. This would go far toward eliminating business measures which were advocated for political purposes and political measure which were supported for business reasons. It would do much to reduce capital's temptation to oppress labor in order to increase or maintain dividends, and labor's temptation to retaliate upon capital by attempting to transfer to the wage earner a large share of the investor's expected return.

Professor Schluter's plan also includes some suggestions which bear directly on the place of accounting in the new scheme of things.[5] Among other elements he described a proposed "National Institute of Accounting" organized within a "National Economic Council" to function as the fact-finding, reliability-testing agency of the whole scheme of Business Self-government. This Institute would consist of three divisions. The first section would design accounting systems and indicate the accounting principles to be followed therein. The second section would be mainly statistical since it would receive the summaries and reports prepared by the various major divisions of industry from the data supplied by all individual enterprises, and compile data therefrom which would form the basis of national business policies.

The third section of this Institute is particularly interesting for it is described as the "Major Board of Auditors." Members of this board would have "appointment prerogatives and privileges similar to those of members of the Supreme Court of the United States." The board would sit as a court upon questions of non-conformity to the required accounting procedure as revealed by audits and as an arbitrator upon questions involving valuation and price determination when these latter matters could not be settled by agreement within the respective trade and industrial associations. This body therefore would police the various accounting regulations and do much of the valuation work now done by state or federal commissions.

The staff to accomplish this work would necessarily be very large; it would include the field and office men of the Income Tax Bureau, the national bank examiners, the accounts section of the Interstate Commerce Commission, and the whole body of public accountants. Such a reorganization, it is said, would eliminate the present system of certifying individual public accountants and would centralize the examining or auditing function in one coördinate body under the "Major Board of Auditors."

Does this program accord with the judgment of accountants? Will such a program provide the adequate, appropriate, and re-

[4] *Economic Cycles and Crises*, (Sears, 1933).

[5] Condensed in the ACCOUNTING REVIEW, December, 1933.

liable data which an intelligent, democratic business self-government will need?

Accountants will have no doubts about accountancy being able to supply adequate data of whatever extent desired. Double entry is flexible enough to record and organize any data, and our present knowledge of uniform accounting systems is ample to permit the design of a variety of suitable mechanisms. But accountants, better perhaps than anyone else, are aware of the dangers of over-rigid prescriptions; all business cannot be poured into a few uniform molds. Even different enterprises in the same industry cannot with equal economy follow identical accounting procedures. Adequate data require comparability, of course, but the answer is not found in uniform blank-filling. Sound principles and comparable key-results are far more important than bookkeeping forms and over-standardized reports. Such considerations as these will become important if Business Self-government undertakes, as has been suggested by Prof. Schluter, to make uniform accounts universal and to collect statistics of accounting results for the formation of financial statements for whole industries and perhaps a balance sheet for the whole country.

Few accountants would have any doubts about accountancy being able to furnish appropriate as well as adequate information. The data from accounts have consistently improved in appropriateness throughout a long history; that is, accounting data have continued to fit the growing needs of the questioner. This would not be changed if the management problems being studied should relate to a whole industry or to general welfare rather than to a single enterprise. The key note in accountancy has long been sound principle; and neither volume of transactions nor size of the totals influence principles. Correct distinction between income and non-recurring profits, proper separation of capital expenditures and revenue charges, sound treatment of depreciation, obsolescence and maintenance, full, intelligible disclosures in the statements—these are matters which will always be closely related to the appropriateness of the data. These are the elements, too, which, more than mere uniformity of bookkeeping classification, make data appropriate for study when facing the problems of controlling business activities wisely. It is vastly more important that principles such as these be given full consideration than that all data be fitted into one prearranged scheme of accounts and that all reports be made on 10×14 buff paper.

Reliability of data was mentioned. Adequate and appropriate facts are not enough. If they are not trustworthy they are useless —even worse than useless, for they may actually be deceiving and misleading and therefore worse than the entire absence of figures. Consequently, if accounting data are to be serviceable for social planning, they must by all means be reliable.

But standardized accounts prescribed in detail by political bureaus will not assure reliable figures. If the system is too rigid, new conditions will be fitted into the established mold and the results may fail to reveal the significant changes. Furthermore, even the best system is capable of studied misunderstanding of wilful manipulation, and there again the results will fail to reflect the truth. The recorded results, whatever the system, must not go untested. In fact accountants generally will no doubt support the contention that adequate tests of results are even more important to the final usefulness of the data than either rigidly standardized accounts or central tabulation of data from all enterprises. Since the data will need testing for reliability, the next question is the manner in which the testing could best be accomplished.

Suppose we grant that a growing consciousness exists of the superiority of the social interest over individual interests, and that men have become capable of voluntarily subordinating their skill in competition to the general welfare; suppose we grant that economic evolution seems to point to an ever increasing dependence upon factual data to guide business and social judgments; and suppose we further grant the advisability of standardizing all accounting and of working over all of the collected accounting

data into national planning statistics. If we accept all these, does it necessarily follow that the social interest also requires regimented auditing to replace that performed by independent experts?

The social interest may need adequate, appropriate, and reliable factual data concerning business so that intelligent men may have a sound basis for associating themselves in formulating business policies which will not be contrary to the general good. And adequate and appropriate data may very well be prescribed for all enterprises by any suitable body designated for this task. But inspection and critical examination should be separately conceived and separately executed.

Accountants would not be wholly biased if they should say that bank examining might be better conducted by independent auditors than as an adjunct to the office of the Comptroller of the Currency or the State Auditors, or that railroad accounts are neither too extended nor too intricate for independent examination. Accountants therefore may not be ready to accept the model proposed for auditing under Professor Schluter's plan for Economic Self-government. It would be just as logical, if not more so, to expect good results to follow upon a thoroughgoing reorganization of accountancy as an independent profession in such a way as to add specially trained bank examiners and railroad specialists to the ranks of professional practitioners (with appropriate group-designations) rather than to submerge the independence of accounting examinations in a gigantic bureaucracy.

The idea described as the Major Board of Auditors, with its very high responsibility as a sort of Supreme Court of Valuations, is a very excellent one. But such a board, being critical and judicial in conception, should be divorced from any responsibility for designing systems or devising operating procedures. And auditing should be related to the board somewhat as the practice of law is related to the judicial system. Audits should be required of all enterprises above a certain minimum size; but auditors should be independent both of the operating enterprise and the system-prescribing, statistics-collecting agency. The choice of auditors should rest with the representative control board of the enterprise which would be elected jointly by all investors and workers (in place of a stockholder-elected board of directors) and the audit fees should be paid by the enterprise. But it should be provided by law that the auditor could be replaced only for cause after a hearing before the Major Board of Auditors and that he could be penalized for fraud, misconduct, unprofessional acts, etc., only by this board. This last would strengthen the accountant's arm in a way which would be very much in the public interest.

The weakness which runs throughout the original proposals for the accounting section of Business Self-government is that too little provision is made for a separation of the judicial function. A body which prescribes rules is legislative, even if these are informal rules devised by voluntary associations of business enterprisers; whoever critically views the operation of these rules is active in a judicial capacity even if he should be a lone professional accountant. It is just as unwise in economic government as in political government to combine these two functions. The proposals for the divorce of business government from political government are fascinating in the possibilities they contain for another attempt to achieve the American ideal of a universal high standard of living under a democratic system. But men do not easily accommodate themselves to outright new institutions or an over-extended re-alignment of forces. And it would be wiser therefore to keep rule making and rule judging separate in business in the same way that has proven so beneficial elsewhere in our history.

It may be that the third phase of the evolution of accountancy will not be merely the socialization of accounting through universal accounts and the statistical tabulation of extensive accounting data; perhaps it may also include the ultimate elevation of auditing to the judicial place for which its nature so well designs it.

The hardest part of accountancy's evolu-

tion therefore lies still ahead—the achievement of a real recognition of the judicial character of auditing. This accomplishment involves much more than the enactment of a statute for compulsory audits in the British precedent. Such a statute alone might lead us into a type of self-complacency which would stop accountancy's development far short of its possible destiny. More is needed than compulsory audits. For one thing it is particularly important for the period ahead to witness a clear-cut recognition of the distinction between accounting and auditing, that is, between the calculation of the net earned income according to the best methods that can be devised, and the critical, judicial examination of business results with the interests of all parties in mind. The separation has already begun under the activities of cost accounting and comptroller-constructed budgets. That separation should continue until accounting shall be consciously restricted to the "telling," or records, side of business, and auditing shall be confined to the "hearing," or critical, side.

The period ahead then should be one in which auditing is consciously striving to achieve a real maturity. Compulsory audits, instead of indicating an accounting millenium, should mark the beginning of a new period of self-searching and improvement. There should be occasion for a very considerable increase in professional breadth and depth; there could be a development of auditing technique far beyond traditional office practices; and it would be very desirable if a way could be found to accept full professional responsibility for all professional activities without unnecessary hedging. And finally this third phase in the long evolution of accountancy should above all else be characterized by a growth in our ability to organize a coöperative attack upon the problems which seem imminent and at the same time to maintain steadfastly complete professional independence.

# THE SOURCES OF CAPITAL SURPLUS

RAYMOND P. MARPLE

CAPITAL SURPLUS may be defined as an excess of contributed capital over legal capital. The term "legal capital" applies to all capital which the law requires a corporation to retain intact for the benefit of creditors. It is synonymous with the term "stated capital," although the latter term is usually associated by the layman with no par value stock. American courts have developed many theories, among them the "trust fund," "the fraud," and the "holding-out" doctrines, to support the established rule that the legal capital of a corporation may not be reduced except through formal amendment of the corporate charter or as a result of operating losses in excess of accumulated surplus. In the eyes of the law any net worth in excess of legal capital is surplus, and in the absence of statutory provisions to the contrary, may be used by the board of directors for any desired purpose.

By contributed capital is meant all capital contributed to, or invested in a corporation by its stockholders, past or present, and retained by the corporation. From the viewpoint of the accountant, the entire net worth of a corporation consists of two elements: contributed capital, and earned capital of surplus.

These concepts of contributed capital and legal capital are of fundamental importance to the accountant. It seems hardly necessary to emphasize before a group of accountants the importance of distinguishing between contributed capital and earned capital. But to the lawyer and the courts, legal capital is the important fact, and no matter how much the accountant disapproves of certain legal definitions of capital he must recognize that the force of law makes them facts, and that these facts should be shown on his financial statements.

In order that the accountant may reflect both the legal and the accounting classifications of capital and surplus, it is suggested that the net worth sections of corporate balance sheets be divided into three subsections, as follows:

1. Capital Stock—to show legal capital.
2. Capital Surplus—to show the excess of contributed over legal capital.
3. Earned Surplus—to show the accumulated earned capital.

Where this classification is followed, the capital stock and capital surplus sections can be added together to show contributed capital, while the capital surplus and earned surplus sections taken together show the legal surplus. The title, capital surplus, seems appropriate for the second net worth section since to the accountant this section represents capital, while in the eyes of the law it is surplus.

Capital surplus may arise in any of the following ways:

1. Through the issuance of par value stock for more than par.
2. Through the issuance of no par value stock at more than stated value.
3. Through the forfeiture of partly-paid stock subscriptions.
4. Through assessments, donations and gifts.
5. Through dealings in treasury stock.
6. Through reductions in legal capital.

This list, while not exhaustive, does include the most important ways in which capital surplus is brought into existence. Certain questionable sources of capital surplus will also be mentioned in the discussion that follows.

### PREMIUM ON CAPITAL STOCK

The legal capital of a corporation with par value stock is the aggregate par value of all shares issued. Note that the reference is to shares "issued" not "issued and outstanding." The capital represented by treasury shares is considered a part of legal capital in all states that have adopted statutory definitions of legal or stated capital. Thus the California Civil Code provides:

> Every corporation shall have and carry on its books a stated capital, which shall consist of the aggregate par value of the outstanding shares and treasury shares having par value, and an amount determined according to the statutes for no par value shares[1].

When par value stock is issued at more than par there results an excess over stated capital, which the accountant calls premium on capital stock. Since this premium is not a part of legal capital, it must represent legal surplus and be legally available for dividends. Referring to the statutes, we find that only one state, California, places any restriction on the use of this premium for dividend purposes, and this restriction is only partial. While under the laws of California, such surplus cannot be used for paying dividends on common stock, it may be used for the payment of preferential dividends if the stockholders are given notice of the source from which the surplus was derived.

Turning to the case law on this subject, we find that the decisions may be classified under three heads:

1. Those holding that premiums are profits.[2]
2. Those holding that premium[1] are not profits.[3]
3. Those holding that premiums, while not profits, may nevertheless be distributed to stockholders.[4]

It is interesting to note that the two cases coming under the second classification are both California cases, and that the California statutory law has been changed since these cases were decided, bringing the California rule into agreement with the general rule except for the statutory limitation, previously mentioned, on the payment of common stock dividends from capital stock premiums.

To summarize:

1. All statutes defining stated capital limit it to the aggregate par value of shares issued.
2. Only one state has any statutory limitation on the use of premium for dividends, and this limitation is only partial.
3. The prevailing case law favors the use of stock premiums for dividends.

But to the accountant such premiums are contributed capital. Thus they represent an excess of contributed capital over legal capital and are properly classified as capital surplus.

### STATED VALUE NO PAR STOCK

No par value stock may be one of two kinds:

1. True no par value stock—where the legal capital is determined by the consideration received for the shares.
2. Stated value no par stock—where the legal capital is determined by multiplying the stated value per share by the number of shares issued.

We are not immediately concerned with true no par value stock, since in this type of stock we have the legal and accounting concepts of capital brought into agreement and no need for the capital surplus classification.

The name *stated value no par stock* may be a contradiction of terms; but so is the idea. The practical effect of laws permitting this type of stock is to convert no par into par value stock, but with the nominal value enough smaller than the consideration received for the shares to create a large paid-in or capital surplus for the board of directors to do with as they please.

There can be little doubt after considering the language used in the laws relating to stated value that the intention of such provisions is to reduce the legal capital required to be held for the protection of creditors, and to provide a paid-in surplus with little limitation as to its use. As an example, note the following provision of the Maine law:

[1] California Civil Code, sec. 300b. Cf. also Ohio General Code, sec. 8623–37. New York Stock Corporation Law, sec. 12, as amended by L. 1924, C. 441, sec. 4. Delaware General Corporation Law, sec. 14.

[2] Western & Southern Fire Insurance Co. V. Murphey, 156 Pac. 885 (1916); Smith V. Cotting, 120 N. E. 177 (1918).

[3] Merchants and Insurers Reporting Co. V. Youtz, 178 Pac. 540 (1916); Dominquez Land Corp. V. Daughtery, 238 Pac. 697 (1925).

[4] People V. Travis, 157 N. Y. S. 943 (1916); Ohio V. Franklin Bank of Columbus, 10 Ohio 91 (1840); Union Pacific Life Ins. Co. V. Ferguson, 129 Pac. 529 (1913) Equitable Life Assurance Soc. V. Union Pacific R. R., 106, N. E. 92 (1914).

> The stockholders at a meeting duly called and held for the purpose, or the board of directors when acting under any general or special authority granted by the stockholders, may determine at the time of issue thereof what part of the consideration received for issued shares without par value shall be capital and what part of said consideration shall be paid-in surplus available for dividends and other corporate purposes.[5]

The Colorado law reads:

> The excess, if any, at any given time of the then actual value of the total net assets of the corporation over the amount so determined to be capital, shall be surplus available for general corporation purposes and distribution as earned surplus.[6]

No matter how much the accountant doubts the desirability of such laws, he must agree that their presence on the statute books makes capital determined in this way a legal fact to be reflected in financial statements. Once this is recognized, the accounting problem is no different from accounting for par value stock issued at a premium; the aggregate stated value of all shares issued is set up as capital stock, and any consideration received in excess of this legal capital is carried to capital surplus.

### FORFEITED STOCK SUBSCRIPTIONS

Before taking up the proper accounting treatment for forfeited stock subscriptions we must first determine the effect of stock subscriptions on legal capital. We must decide whether the legal capital represented by a share of stock arises at the time the stock subscription is made, at the time all or a specified part of the subscription price is paid, at the time the stock certificate is issued, or in installments as partial payments are made. The law answers that the legal capital arises as soon as a binding subscription contract has been made. At that time the promise of the subscriber becomes an asset of the corporation and the par value, stated value, or subscription price of the stock becomes a part of the corporate legal capital. Thus the capital stock account should show the full legal capital represented by all shares subscribed for, including partially paid shares at the date of forfeiture.

The statutory provisions of the various states relating to the forfeiture of stock subscriptions vary widely, but for our present purpose we need to consider only one type of provision. We are not concerned with the type of forfeiture that merely effects a transfer of stock from one subscriber to another without any change in the contributed or legal capital of the corporation.

We are interested, however, in the results that follow under laws that provide for the forfeiture of the stock to the corporation, either at the end of a period of grace allowed past-due subscribers, or in default of a bid for shares offered at auction. Under such laws the stock and all payments made thereon are forfeited to the corporation, the forfeited shares return to the status of unissued and unsubscribed stock, the legal capital is correspondingly reduced, and any payments that have been received from the subscriber become capital surplus.

The treatment of payments made on stock before its forfeiture as capital surplus at the time these payments are forfeited to the corporation is based on the idea that these amounts represent contributions by stockholders whose interest in the legal capital terminate with the forfeiture of their subscriptions. Thus the prior payments represent an excess of contributed over legal capital.

Another source of capital surplus is found in assessments collected on fully paid shares. Some states grant the right to irrigation companies, fraternal insurance companies, and certain other types of corporations to levy and collect such assessments pro rata from stockholders. Assessments may be voluntarily agreed to in order to prevent impending bankruptcy or as part of a plan for reorganization. The capital thus contributed being in excess of legal capital belongs properly in capital surplus.

Gifts to a corporation by its stockholders may also be listed as a source of capital surplus. Gifts by major stockholders, especially in times of stress, are not uncommon. In such cases the contributed capital of the cor-

[5] Revised Statutes, 1930, c. 56, sec. 19, as amended by L. 1931, c. 150.
[6] Compiled Laws, 1921, sec. 2248 (f), as amended by L. 1931, c. 70, sec. 7.

poration is increased without a corresponding increase in the legal capital. Thus capital surplus results to the extent of the net value of the gift.

### TREASURY STOCK

Earlier in this paper I stated that, under many statutory definitions of legal capital, corporations are not permitted to reduce their stated capital by the acquisition of treasury shares, and I quoted the California provision to that effect. Instead of going into details regarding statutory provisions and court decisions on this point, let us inquire into the reasoning behind this rule. To allow a corporation to reduce its capital by the purchase of its own shares, is to permit it to return to stockholders funds upon which creditors are presumed to have relied when granting credit to the corporation. Thus, if the corporation is allowed to purchase its own shares without limit, stockholders whose interest in the corporation is residual are enabled to withdraw their capital, partially or wholly, and shift a part of the risk to corporate creditors. This is contrary to the generally accepted theory of American corporate law, and is prohibited in many states by statutory provisions. Surplus, however, not being a part of the legal capital upon which creditors rely, may be used by a corporation for the purchase of its own shares.

Without doubt it is incumbent upon accountants to develop some method of showing compliance with these legal provisions. If only surplus can be used for the acquisition of treasury shares, it seems clear that surplus is reduced by their acquisition, and that it is the duty of the accountant to record this reduction. Otherwise the surplus account will not show the true amount available for dividends.

Two possible methods have been suggested for recording treasury stock transactions in such a way as to show compliance with the legal rule that stated capital may not be reduced by the purchase of treasury shares. Under the first method, the purchase by a corporation of shares of its own stock is recorded by a debit to a surplus-offset account and a credit to cash for the amount paid. This method has the advantage of simplicity, and it shows clearly whether or not legal requirements are being complied with. However, it is open to the objection that it does not properly reflect the economic or business effect of a treasury stock purchase. When a stockholder sells his shares to the corporation, he is withdrawing capital and not surplus. Looking at the transaction from this angle, it is obvious that what really occurs is a withdrawal of capital, followed by a transfer or appropriation from surplus to capital in order to comply with the legal rule that treasury stock purchases shall not reduce legal capital but may be made from surplus.

The second suggested method of recording treasury stock purchases is based on this concept of the transaction. Two entries are needed: one showing the capital reduced by a debit to treasury stock and a credit to cash; the other showing surplus appropriated to replace the retired capital by a debit to surplus and a credit to reserve for treasury stock or some other appropriately named account. Under this plan, the capital stock section of the balance sheet would show first, the par or stated value of issued shares, less treasury stock, plus surplus appropriated to replace the capital returned to the retiring stockholder. Without entering further into the technique of this method, it is obvious that it leads to numerous complications when treasury stock is purchased and resold at prices that differ from par or stated value, and that it results in the same final figures for the capital stock, capital surplus, and earned surplus sections of the balance sheet, as does the first method. Consequently, the first method with its greater simplicity seems preferable.

Under this method of accounting for treasury stock, no profit or loss is shown as resulting from the acquisition by a corporation of its own shares, nor is there any need for the debiting or crediting of surplus or the setting up of temporary suspense accounts. The amount paid for the treasury shares is the only amount to be accounted for, and this is shown as a reduction of surplus by the use of a surplus-offset account.

But when treasury stock is sold, any difference between the purchase and sales price does affect surplus—either earned or capital. If the stock is resold at less than it cost the corporation, there is a loss to be charged against earned surplus. If the stock is resold for more than it cost the corporation, there is an increase in contributed capital to be credited to capital surplus.

In the case of donated treasury stock, there seems to be no need for other than a memorandum entry at the time the stock is donated to the corporation. When donated treasury shares are sold, the entire consideration received is capital or donated surplus. This achieves the same final result as our present practice of setting up the par or estimated value of donated shares as donated surplus and of adjusting this account at the date of sale of the donated shares to show the capital actually resulting from the donation. But the method here outlined does away with the current practice of showing legal capital reduced and surplus increased at the time treasury shares are donated.

To show the absurdity of indicating that a surplus is created by the donation of shares to the corporation, let me ask why it would not be possible for all of the stockholders of a failing corporation to donate their shares to the corporation, to use the surplus thus created for the payment of dividends to themselves, and to leave the creditors of the corporation to bear all losses.

It is obvious that the courts would soon set aside such an agreement on the ground that the legal capital of the corporation existed for the protection of the creditors, and that the amount used for dividends was legal capital in spite of the donation of all shares to the corporation. The same reasoning can be applied to any donation of stock no matter how small. It seems likely that the courts would not permit the legal capital to be reduced in this way.

### REDUCTIONS OF LEGAL CAPITAL

The last two years have witnessed an unprecedented number of corporate capital changes involving the reduction of legal capital. Governor Lehman in speaking before the New York Legislature on March 24, 1933 said, "As recent as in the year 1930, there were only twenty-eight changes in the character of the stocks listed on the two New York Exchanges. Though only thirty-three in the year 1931, the number last year suddenly advanced to 104. And this year has already shown more than sixty-five changes, either actually made or in process."

Time permits only an outline of the more important reasons for these capital reductions:

1. State franchise taxes and state and federal stock transfer taxes discriminate in many cases against no par value shares by taxing them at the same rate as $100 par value shares. Shares with par values are taxed on total nominal values. This has made a share with a small par value preferable for tax purposes to any no par value share with a stated value of $100 or less. Corporations have changed their stocks to low par value to reduce taxation.
2. Capital reductions to create surpluses available for the following purposes:
   (a) Elimination of deficit
   (b) Write-down of asset values
   (c) Charging off of extraordinary losses
   (d) Payment of dividends.

Other reasons might be mentioned, but these are the important ones.

The reduction of legal capital is rather minutely regulated by statutory provisions in a majority of the states. In general, to reduce legal capital, it is necessary to amend the articles of incorporation. This can usually be done by a vote of a majority or two-thirds of the shares entitled to vote, or of each class of stock voting separately, provided the articles as amended would have been legal and proper in the original charter. The limitations on the use of this power to reduce legal capital are quite various, and in most cases appear rather ineffective. The most general provision is that no such reduction shall be made if it renders the corporation insolvent or bankrupt.

Legal capital may be reduced in a number of ways, which I have classified under three heads according to the effect on surplus.

1. No effect on surplus if retired at par or stated value.
2. Causing an increase in free earned surplus.
3. Causing an increase in capital surplus.

When a corporation, after amending its articles of incorporation, purchases its own shares for retirement, it may either retire all shares of a class of stock subject to redemption, draw shares by lot, or purchase its own shares in the open market or at private sale (usually with some restrictions).

If the stock is acquired at par in the case of par value stock, or at stated or book value (per the capital stock account) in the case of shares without par value, the legal capital is reduced by the value of the assets given for the stock and the surplus of the corporation is not effected. But if the shares are acquired at less than par or stated value, a capital surplus is created, since the legal capital is reduced by a larger amount than the contributed capital. Stockholders have left a part of their contributed capital in the corporation. If the shares are acquired for retirement at more than par or stated value, the effect is to return to the stockholders not only the legal capital contributed by them but a part of the accumulated surplus. The excess over par or stated value is, therefore, a charge against earned surplus unless the stock was originally issued at a premium, in which case capital surplus should be debited to the extent of the premium previously contributed by the shares retired.

Most state laws permit the reduction of legal capital through the retirement of shares held in the treasury. Since, in general, treasury shares can only be acquired from surplus, the effect of retiring these treasury shares is to make free and available for dividends a part of the earned surplus previously invested in treasury shares.

It is probable that in a majority of cases capital reductions are resorted to in order to create a surplus. In such cases, any of the following methods of capital reduction are available:

1. Pro rata reduction in the number of shares outstanding.
2. Reduction in the par or stated value of shares outstanding.
3. Changes from par value shares to shares without par value, with a stated value smaller than the previous par.
4. Changes from no par value shares to shares with a par value, with a smaller par than the previous stated value.

In all such cases, the capital surplus of the corporation is increased at the expense of the legal capital. The number of shares outstanding or the legal capital represented by each share is reduced without any return to the stockholders of the capital contributed by them.

Surplus from appreciation is often mentioned as a source of capital surplus. This so-called surplus usually represents the difference between the appraised present value and the present book value of assets. Such difference may be due to any of the following causes:

1. Excessive depreciation
2. Previous capital charges made to revenue
3. An unearned increment
4. A decrease in the purchasing power of money.

Where the difference is due to excessive depreciation in the past, or to the prior practice of charging certain capital expenditures against income, it is apparent that the proper correction should be made against earned rather than capital surplus. Where the appreciation represents an unearned increment, it seems more closely allied to earned than to capital surplus. Since it becomes earned surplus through realization, it seems a little far fetched to call it capital just because it has not been and may never be realized.

A generally accepted method of accounting for changes in the purchasing power of money has not yet been developed. There appears to be some arguments in favor of recognizing major price fluctuations in the accounts. However, any satisfactory method of doing this will result in restating net worth as well as assets in terms of the current dollar. Consequently, the value represented by capital surplus would not be changed by such

an adjustment, even though the dollar amount were increased to reflect a decreased purchasing power. For these reasons, it is felt that surplus from appreciation does not properly belong in capital surplus, as here defined.

DISCUSSION BY PROFESSOR KESTER

Mr. Marple has given a very able presentation of his topic "Sources of Capital Surplus." I do not intend in my discussion of his paper to present any new material as to the source of such surplus, nor do I intend to take serious exception to anything which he has said, for I am, in the main, in full accord with the material which he has presented.

From the standpoint of one who approaches the subject from any other than a strictly legal point of view, there will probably be little difference of opinion as to the basic principles involved. There doubtless will be, however, some difference of opinion as to the accounting procedures which Mr. Marple has suggested in connection with some of the situations relating to capital surplus. For example, the method of presenting treasury stock on the corporate balance sheet as a charge in total against surplus may not be in accordance with views generally held, because it does not indicate as clearly as is sometimes desirable the number of shares of capital stock outstanding in the hands of the public. That method of handling does, however, just as effectively reduce the capital in use by the company as the other more usual method, which treats treasury stock as an offset to capital stock, with only the difference between purchase price and the carrying value of capital stock as a surplus adjustment.

Mr. Marple's treatment of revaluation surplus is sound. Without a knowledge as to the factors behind the revaluation, that is, its causes, it is impossible to give a correct accounting treatment to it.

In the short time allotted to me I would like to raise the question as to the uses of capital surplus, because it is here that there is a variety of practice and a too apparent difference of opinion. I do not want to base my remarks on what is and what is not legally permissible as to the use of such surplus, but rather on what is right and proper, that is, what constitutes a sound fiscal policy. Briefly, my position is this: capital surplus is essentially paid-in capital and should be used for only those purposes for which capital stock may, with propriety, be used. The capital contributed by shareholders is normally contributed to be used for permanent investment in corporate activities. When a man pays in capital to a corporation, he does not ordinarily expect to receive any portion of that capital back, excepting upon the reorganization or liquidation of the corporation. Accordingly, if acting under the permission granted by the laws of some of our States, contributed capital is booked partly as a credit to capital stock account and partly to a paid-in or capital surplus account, the capital recorded in the surplus account is just as much permanently contributed capital as that recorded in the capital stock account and it should be so used.

Ordinarily no losses should be charged against capital surplus so long as there is a sufficient balance of earned surplus to absorb such losses. If, however, it is the desire of the stockholders to reduce the amount of contributed capital and the necessary legal action has been taken for that purpose, there is no objection to a withdrawal of originally contributed capital by recording such withdrawal as a charge against capital surplus, without making any adjustment of the capital stock account. This attitude is not yet recognized by the business community as necessarily right and proper, as evidenced by the number of recent instances in which corporations—even many banking corporations—have reduced the par value of their capital stock and so created a paid-in or capital surplus account in the amount of the reduction. Against such paid-in surplus have been charged off extraordinary losses arising largely out of the period of the depression. By this means earned surplus has been retained intact and thus has become available for future dividends. On the other hand, there are a few outstanding exceptions to this practice, in accordance with which all losses have been charged off against earned surplus

until that has been entirely used up. If there have been any additional losses these have quite properly been charged against capital surplus, because originally contributed capital has been impaired by such losses and the record should so indicate. The usual attitude of corporations towards capital surplus seems to be based on what recent liberal statutes will permit, rather than on what a sound fiscal policy will dictate.

In closing my discussion I want to emphasize what in my opinion cannot be too strongly emphasized, viz; that in the construction of balance sheets there should always be a definite segregation of the three groups—assets, liabilities and proprietorship, and a showing under the proprietary group of all of the items composing that group. If, in any case, there is more than one kind of surplus, such as both earned and capital surplus, supporting schedules covering all changes of surplus for the past fiscal period should be made a part of the balance sheet report.

# THE ACCOUNTING EXCHANGE

## Teaching Accounting Systems

The subject, "Accounting Systems," is at the same time one of the most difficult and the most valuable that the student specializing in accounting is called upon to master. Its difficulty and also its value lies not so much in its content as in its method. A good course in accounting systems is perhaps the most rigorous and comprehensive test to which a student's knowledge of accounting principles may be subjected. The accounting specialist is continuously called upon to meet a maze of ever changing accounting problems. His knowledge of accounting principles will not produce the utmost in results unless he has been given a rigorous training in their application. If he must rely entirely upon practical experience for such training he will lose much valuable time. A good course in accounting systems will do much to advance him in his profession.

A course in accounting systems is usually offered by a university which permits students to specialize in accounting. According to Bossard and Dewhurst[1] twenty institutions offered such a course in 1931. Aside from courses in elementary and advanced principles, the importance of the course in systems is exceeded only by those in cost accounting, auditing and income tax accounting.[2] Indeed, according to Professor Newlove[3] the systems courses in graduate schools in 1927 exceeded in number the income tax courses. Furthermore, he has classified separately courses in governmental accounting and public utility accounting, which ordinarily are included under the heading of systems. If the courses in public utility and governmental accounting are included under the heading of systems, this type of course led even cost accounting and auditing. It is thus seen that the subject of accounting systems is of major importance in both the undergraduate and graduate schools of business.

From the standpoint of methods followed in teaching accounting systems, there are no doubt many approaches in present use. No study has been made, in so far as is known, of the methods pursued in teaching courses in accounting systems in the various schools of business. In the opinion of the author, however, there are at least three possible approaches. In the first place, one may present the subject as a course in methodology. That is, from the standpoint of the method which should be followed by an accountant in undertaking the preliminary investigation and subsequent installation of an accounting system. A course of this nature must necessarily be somewhat superficial. Strictly speaking, a course in system methodology would be a theory course somewhat deficient in materials and probably uninteresting to the practical accounting student. In the second place, a systems course may deal primarily with the principles of system installation. In such a course, the principles of system construction would first be studied and later problems requiring the construction of systems for individual businesses would be solved, such problems being of a more or less hypothetical nature. While having some advantages over a system methodology course, a course in principles of system installation is too theoretical and abstract for most accounting students, especially those who expect to secure positions in large industrial centers, where accounting problems are encountered requiring for their solution a more intimate acquaintance with reality. From the standpoint of accounting practice, familiarity with the details of operation of many different types of business and the accounting problems normally encountered in them is ordinarily essential. The accounting student must, therefore, in so far as possible, be made acquainted with the facts of the major types of industry in his community. The first two methods of approach, therefore, have many shortcomings in training students for prac-

[1] Bossard, James H. S. and Dewhurst, J. Frederick, University Education for Business, Univ. of Pa. Press, 1931, p. 394.

[2] Ibid.

[3] Newlove, G. H., "Graduate Course in Accounting," the Accounting Review, Vol. II, No. 2, June 1927, p. 167.

tical accounting work, particularly in Universities in the larger industrial centers. The third type of systems course involves the application of accounting principles to the solution of concrete accounting problems arising in various types of industry. By problem is here meant any situation rising because of legal, engineering, governmental, economic, or other requirements conditioning or affecting the carrying out of an accounting assignment. The application of accounting principles in the solution of such problems requires the utmost in practical accounting judgment.

A course in accounting systems, which embodies elements of all three approaches and meets most of the shortcomings stated in the previous paragraph, is one which approaches the subject of accounting principles from the standpoint of solving practical accounting problems arising in actual practice and surrounded, in so far as possible, by the actual facts that are apt to be met by a practicing accountant. In pursuing such a course the student is required to analyze existing accounting systems in order to familiarize himself with the accounting problems ordinarily met in the most common types of business in his community. When an assignment involving work with an unfamiliar system is then undertaken, he can rely upon his ability to deal with accounting problems previously encountered as well as upon his knowledge of principles of procedure and installation. It is possible to train the student in the methodology of system installation and the principles to be followed in constructing accounting systems. However, the numerous practical conditions which are confronted in practice, as for example, the requirements of governmental regulatory bodies and trade associations, or the customs and practices which have arisen in certain types of business, make it impossible to depend entirely upon a training in methodology or principles of installation. It has been found by experience in the teaching of accounting systems that there is no substitute for actual contact with the facts of industry and the methods being used by practical accountants to solve the problems of accounting.

The balance of this paper will be devoted to a consideration of the problems of organizing and teaching a course in accounting systems of the type described in the previous paragraph. That approach to the subject seems to offer the greatest possibilities for success in training accounting students to become versatile and intelligent public accountants and accounting executives. Such a course might well be entitled "The Application of Accounting Principles to the Facts of Industry."

The principles of accounting may be grouped under four heads, as follows.

a. The Principles of System Installation.
b. The Principles of Bookkeeping.
c. The Principles of Auditing.
d. The Principles of Statement Preparation and Use.

These principles constitute the philosophy of accounting with which all accountants must be equipped. A thorough knowledge of them must be gained by students in courses in elementary and advanced accounting before a course in accounting systems is entered upon. Experience in teaching has shown that a comprehensive drill in the application of accounting principles serves to clarify these principles in the minds of the students and would be extremely worth while if no other purpose were served. The chief value of a course in the application of principles, however, is in the development of a student's analytical ability and judgment. After all, as a practicing accountant he will be required to make definite decisions daily in his work and the correctness and expediency or practicability of these decisions will determine very largely his success.

The field of industry or business in which the practicing accountant works may be organized along some such lines as the following:

a. Commercial
   1. Financial
   2. Merchandising
   3. Extractive
   4. Manufacturing
   5. Public Service
   6. Transportation
   7. Professional

b. Institutional
   1. Educational
   2. Charitable
   3. Religious
   4. Hospital
   5. Fraternal

c. Fiduciary
   1. Estates
   2. Receiverships
   3. Bankruptcy
   4. Trusts

d. Governmental
   1. Federal
   2. State
   3. Municipal
   4. Borough
   5. County
   6. Township

e. Consumption
   1. Household Budgets
   2. Personal Budgets

From the standpoint of training professional accountants, the application of accounting principles to the entire field of industry will not have to be undertaken. Indeed, it would be impossible to cover the entire field in a systems course of reasonable length. It becomes necessary then to make a selection of systems to illustrate the application of principles. A choice of systems may be made upon the basis of illustrating the different types of accounting problems encountered. Care should be taken, of course, to include those types of enterprise common to the locality in which the accountant is likely to practice. In a large university whose student body is composed of students from other states and other countries, the course in accounting systems must be broad enough to train the student to meet accounting problems which are more or less universal. Such a course is in mind in the present case. The systems selected should be those which offer the student the maximum amount of training not only in the application of accounting principles but in the operation of the different types of industry. As indicated above, it is not important that all phases of industry be covered. If properly trained, the accountant can handle readily most assignments involving small businesses, whether or not he has had specific training in them. It is not necessary, for instance, that an accountant have had prior contact with the garage business in order to have success in installing and operating a system for a garage. He should, however, be well versed in the method of approach necessary to uncover the accounting problems to be solved in such an assignment, and should have had prior contact with similar accounting problems in other lines of business. For example, experience in applying the principles of auditing to the facts of a Railroad business is very valuable in solving the auditing problems arising in a Fire Insurance Company assignment even though the two businesses are of entirely different types. In planning a course in accounting systems then, many of the types of industry above enumerated may be omitted from consideration and a judicious choice made from the remaining ones to the end that a representative group of cases is obtained to illustrate all important accounting problems.

There are several types of business, the accounting systems of which should no doubt be included in a course planned for students in a large metropolitan area. Such a course might include:

1. Building and Loan Association Accounting
2. Insurance Accounting
3. Bank Accounting
4. Brokerage Accounting
5. Mercantile Accounting
6. Manufacturing Accounting
7. Public Utility Accounting
8. Transportation Accounting
9. Governmental Accounting.

The accounting problems of a building and loan association revolve around the receipt and disbursement of cash. The accounting system consequently is built around cash records. Accounts must be kept for individual shareholders, mortgage and stock loans, real estate, etc., as well as for items of income and expense. Postings to all of these accounts must prove with the cash book, and it becomes the chief accounting record, often to the exclusion of a general ledger. Another important problem is the distribution of profits.

The insurance business is becoming more and more prominent in all sections of the country. A study of the accounting problems typical of this type of industry, is therefore, very useful to accounting students wherever situated. Some of its accounting problems are (1) the control which must be exercised over agents and insurance risks, (2) accounting for losses and claims as they occur and are adjusted, and (3) meeting the requirements of state insurance commis-

sioners with respect to the type of security which may be invested in, the reserves which must be maintained, and the annual reports to be prepared. From the standpoint of the application of accounting principles, the study of the accounting system of a fire insurance company in particular offers an opportunity for a thorough drill in accruals, prepayments and other adjustments which have to be made periodically by most companies.

The accounting problems of a bank also relate chiefly to the receipt and disbursement of cash. Because of its varied functions of receiving deposits, granting loans and discounts, providing exchange, etc., requiring an organization into departments specializing in the handling of certain types of transactions, the problems of accounting control and internal check assume a greater importance in a bank than in most businesses. The use of a cash book to control cash transactions is decidedly important, and this feature may be stressed, therefore, when the accounting system for a bank is under consideration. The application of the theory of internal check also may be considered in its entirety at this point.

While a bank's dealings are largely in cash, a brokerage house deals in another commodity besides cash, namely, securities which it buys and sells for its customers. A dual system of accounts, therefore, is necessary, first the financial accounts to record the financial transactions, and, second, the security accounts to record the security transactions. The problem of accounting for security transactions is clearly as important as accounting for financial items. The student may here be introduced to the principle of "long" and "short," which is as significant in accounting for securities of customers as the principle of "debit" and "credit" is in accounting for financial transactions. Once having considered the problem of dual accounting in the case of a stock brokerage house, it becomes unnecessary to consider such a problem in connection with any other type of business. The accounting system of a stock brokerage house, therefore, serves as the second step in the transition from the simplest type of accounting system where the cash book predominates to the more complex systems which will be considered below.

A study of the accounting problems peculiar to mercantile establishments logically follows that of financial institutions. Here provision must be made for the recording of merchandise purchased and sold and for controlling merchandise inventory, as well as for keeping a record of cash. The problem of retail inventory control and accounting for purchases and sales of merchandise may be considered in their entirety when considering the application of accounting principles to a mercantile establishment, such as a department store. The department store embraces all of the important accounting problems encountered in mercantile establishments and in addition the problems of account classification and expense distribution. In the mercantile business emphasis is placed upon current assets and quick turnover. In this respect it represents the second step in the transition from the extreme liquidity of the assets of financial institutions to the fixed assets of manufacturing, public service and transportation companies.

The accounting problems of a manufacturing company and also those of a public utility may be illustrated by considering the accounting system of a manufactured gas company. Cost accounting problems are of course omitted in a systems course since it is probable that a specialized course in cost accounting is offered by most schools offering a systems course. A system for a manufactured gas company must account for the purchase of raw materials, labor and overhead and their manufacture into a finished product. Accounting for by-products, depreciation, retirements and new construction are problems to be stressed also in this type of business. Instead of the purchase and sale of merchandise, as in the case of a mercantile establishment, the production of a commodity or service for sale is the main purpose of a manufactured gas company. The student also is afforded the opportunity of seeing an account classification in actual operation. This classification usually is prescribed by the state public service commission, and a care-

ful study of it enables the student to test out his knowledge of accounting principles. He is impressed with the fact that he should be on his guard as to the meaning of the names of accounts when he first contacts a new type of business. Prevailing custom and regulations in different industries condition very definitely the work of the accountant, and he must necessarily become familiar with them in order to be able to do his work efficiently.

The study of the accounting system of a Steam Railroad Company also brings the student into contact with problems met by public utilities, particularly those connected with transportation. A railroad company operates over a very wide territory as compared with a gas or electric company, and consequently faces problems of accounting for revenue and expense which are quite unique. The auditing of freight and passenger revenue and of disbursements involve problems not emphasized in any other type of business. A study of this feature of railroad accounting enables the instructor also to consider the organization of an accounting department. The functions of the accounting department of a railroad company consist of (1) the proper preparation and submission periodically of correct reports of transactions consummated at various points on the system, (2) careful auditing of these reports at the central office accompanied by periodical visitations of traveling auditors for the purpose of examining the records serving as the basis of the reports, (3) the systematic summarization and classification of the data contained in the reports and the preparation of this information for final record on the general books of the company, (4) the actual recording of the transactions of the company upon the books in such manner as to maintain control over subsidiary records and at the same time reduce to a minimum the volume of detail carried in the general ledger. Thus, the study of the accounting system of a steam railroad company familiarizes the student with the possibilities of using control accounts and subsidiary records. A large railroad company must collect, verify and summarize a volume of transactions which is almost inconceivable. One railroad company, for example, employs 1,800 persons in the performance of one part of a single function, namely the auditing of disbursements. The ease with which such a volume of accounting work can be kept under control through the use of subsidiary records and control accounts is a revelation to the accounting student.

The course in accounting systems outlined thus far, deals only with private enterprises. It is thought advisable to include some form of governmental accounting. The principles of governmental accounting in a general way apply in the system of a national government, state government, municipality, or other similar sub-division. It is not sufficient, however, to study the general principles only. It has been stressed repeatedly that familiarity with the actual conditions confronting the accountant in practice must be studied. This is just as true in the case of governmental accounting as in the case of private accounting. The municipality is a governmental body with which practically every student is somewhat familiar, the problems encountered by it are representative of those encountered by most governmental units. The primary distinction between private and governmental accounting is, that, in the former, emphasis is placed upon keeping expenses below income, in order that a profit may be produced, while in the latter emphasis is placed upon securing sufficient income to cover the necessary expenses involved in performing the services required by citizens. This distinction necessarily affects the accounting system, and is offered as the reason for the widespread use of budget or fund accounting in the case of a governmental unit. While budgetary control is important in private enterprises, and might well be considered in connection with any of the accounting systems, it is particularly important in the case of governmental and institutional accounting. Application of the principles of budgetary control might therefore be considered fully when this type of system is taken up. The problem of control over appropriations is solved in the case of a government unit, by the use of budget-

ary or fund accounts, as distinct from proprietary accounts. The advisability of solving similar problems in the case of private industries may be considered at this point.

One of the most important considerations in teaching a course in accounting systems is the method of approach. For most of the systems covered the standard approach may be followed. As explained above the course in accounting systems is primarily a course in the application of the principles of accounting to industry. Since this is the case, it is essential that a study of an accounting system be prefaced by a thorough study of the nature of the organization and methods of control of the business in question. Such a study follows the same lines that would be followed by a practicing accountant when called upon to install or revise a system. It has been found that a thorough understanding of the nature of the business is most essential to a consideration of its accounting problems. Where possible, the accounting problems should be listed and discussed before an attempt is made to solve those problems through the installation of accounting books and records.

Following the consideration of the nature of the business and its accounting problems, a careful consideration of the account classification and the statements to be prepared should be undertaken. An account classification is prepared with due consideration for the type of business, its size and location geographically, as well as the type of organization and management. By this means, the student is further instructed in the nature of the business, and the solution of its accounting problems. The statements and the account classification are sometimes prescribed by governmental regulation, and hence the student should become thoroughly familiar with their contents and form.

The analysis of typical transactions naturally follows a consideration of the accounts involved, and is definitely related to the functions performed by the business whose accounting system is being studied. The most difficult task for the student is the analysis of transactions into their debits and credits. It has been found in the teaching of accounting systems that a thorough drill in journalizing is necessary, not only to more thoroughly familiarize the student with the nature of the transactions involved in a given type of business, but also to develop his analytical ability, the most important single characteristic of a successful accountant.

When the student is familiar with the accounts of a business and how they operate, he is in a position to take up the study of the books and other records which are necessary to collect, audit, summarize and record the accounting data, and to provide a system of internal check for the business. For most modern businesses, especially the larger ones, the volume of transactions is so great that the average student becomes absolutely lost, unless he has first gained a thorough understanding of the operation of its accounts. When approached in this manner, the student is placed in the position of considering only one element at a time, and can understand more readily the reasons for the various records in use.

The last step in the method of presenting accounting systems is a study of special considerations which might be involved in each type of business. In most cases, for example, some time should be devoted to the analysis and interpretation of the accounting reports. It has been found that the teaching of this phase of accounting helps to clarify the accounting problems and their solution. When the student attempts to analyze accounting reports, he begins to see more clearly the reasons for special types of records and the accounts which are in use. Another advantage of studying statement analyses in the case of each system studied, is the interest which it arouses in the subject. No course is entirely successful unless it is able to stimulate the interest of the student and create in him a favorable attitude toward it. This often may be accomplished through the analysis and interpretation of reports.

Because of the limitation of time no attempt should ordinarily be made in teaching accounting systems to consider each system in its entirety. From the standpoint of training accountants for practical work, the consideration of every detail for each account-

ing system studied would involve too much effort, and would be rather uninteresting to the student. Furthermore, too close attention to details is apt to give the student an idea that there is only one way of solving a given accounting problem. After all, no two situations that an accountant encounters, are exactly alike, and the student should be prepared to adapt himself to new situations, and not attempt to apply detailed knowledge in the same manner to every case. It has been found that through the proper selection of systems to be studied, and a proper emphasis upon the accounting problems peculiar to each system, the student can be trained to meet practically any situation that arises in any type of business. A problem, for example, which he has been taught to solve in connection with a railroad business, might be solved equally well in the banking business, by following a similar line of procedure. An attempt should be made, therefore, to stress for each accounting system, the type of problem most peculiar to it.

In the foregoing paper some of the problems involved in teaching the subject of accounting systems to University students are considered. Throughout the discussion, the welfare of the student has been kept in mind. Many years of teaching this subject has led the author to believe that the method recommended here is the best one. The difficulty of the subject is the chief problem, and the course must be so organized as not to confuse the mind of the student. The plan of procedure in presenting a course in systems should be such as to produce the maximum of assimilation of the subject matter by the student. The logical arrangement of the subject matter is not nearly so important as its arrangement in such a manner that the student may readily understand each succeeding step which is taken. It has been found that in teaching bank accounting, for example, consideration first should be given to the nature and functions of the banking business in general and the accounting problems of a bank, followed by a careful study of the bank balance sheet and the operation of the accounts contained therein. Thorough familiarity with the operation of these accounts and the effect produced upon them by the various types of transactions commonly entered into by a bank, is essential before the study of books and records is taken up. When a consideration of the teller's settlements and subsidiary books and records of a bank is then undertaken, the student may concentrate upon the functions of summarizing the numerous transactions involved, and of internal check. In other words, by following this procedure the student first becomes thoroughly acquainted with the operation of a bank without consideration for the vast volume of detail which must be summarized and checked. He is thus led gradually from one point to another with the least possible confusion. Similar illustrations might be given of the method pursued in developing instruction in the accounting systems of other types of businesses. It must be concluded, therefore, that the most important consideration aside from the actual selection of the material to be contained in the course, is its method of presentation to the student. In a course in accounting systems, the question of pedagogy is paramount.

Oscar S. Nelson

# CONVENTION REPORT

*American Association of University Instructors in Accounting—Proceedings of Eighteenth Annual Convention, Philadelphia*

The 18th annual convention of the American Association of University Instructors in Accounting was held in the Benjamin Franklin Hotel, Philadelphia, Pennsylvania on December 28 and 29, 1933. The program was as follows:

*Thursday, December 28, Morning Session*

General Topic: School and Governmental Accounting.

Papers were read by Hiram T. Scovill, University of Illinois; William H. Welcker, C.P.A., Philadelphia; Fayette H. Elwell, University of Wisconsin; T. L. Hungate, Auditor, Teachers College, Columbia University. Discussion was led by H. I. MacLean, University of Pennsylvania.

*Thursday, December 28, Afternoon Session*

General Topic: Costs and Values.

Papers were read by Charles Reitell, University of Pittsburgh; John Balch, C.P.A.; William A. Paton, University of Michigan. Discussion was led by W. P. Fiske, Massachusetts Institute of Technology; and David Himmelblau, Northwestern University.

*Thursday, December 28, Evening Session*

Address: Accounting Evolution: Third Stage, A. C. Littleton, University of Illinois.

Report of the President.

Report of the Secretary-Treasurer.

*Friday, December 29, Morning Session*

General Topic: Problems of Distribution.

Papers were read by Paul W. Atwood, Secretary Research Council, Association of National Advertisers, Inc.; C. M. Schmalz, Harvard University; Wilford L. White, University of Texas. Discussion was led by Harvey G. Meyer, University of Tennessee; and Edward J. Filbey, University of Illinois.

*Friday, December 29, Afternoon Session*

General Topic: Problems of Accounting Research.

Papers were read by Max J. Wasserman, University of Illinois; L. L. Briggs, University of Vermont. Discussion was led by Roy B. Kester, Columbia University; Jacob B. Taylor, Ohio State University; and James L. Dohr, Columbia University.

Election of Officers.

The annual dinner was held on Tuesday, December 28, at 7:00 P.M. At this dinner President Newlove asked each member to arise in his turn, and to announce his name and his connection. Following the introductions, the President appointed an auditing committee consisting of E. J. Filbey, H. H. Baily, and G. E. Lukas, all of the University of Illinois.

The Secretary-Treasurer then read his report for the year, and also reported on the meeting of the Executive committee held earlier in the day; the Executive committee had instructed him to consult with E. J. Filbey in regard to the safety of the funds of the Association in Building and Loan stock and notes, and, if it appeared desirable to do so, to leave the investing of surplus funds unchanged. The matter of subscription rates was delegated to the Editor and Secretary. The Secretary was instructed to circularize the executive committee for suggestions looking toward an increase in the circulation of the ACCOUNTING REVIEW. The suggestion for auditing the books at the Secretary's office was approved. The Editor and Secretary-Treasurer were instructed to publish the results of the audit in the ACCOUNTING REVIEW.

Past-President Greer reported that the Research Council is organizing and would have something more definite to report at some later date.

At the business meeting held late in the afternoon of December 29, the report of the resolutions committee was heard and approved. The nominating committee, consisting of R. B. Kester, Columbia University, D. Himmelblau of Northwestern University, and H. T. Scovill of the University of Illinois, placed the following persons in nomination:

For President in 1934, J. L. Dohr, Columbia University

For Vice-President, J. B. Taylor, Ohio State University

For Secretary-Treasurer in 1934, Chas. F. Schlatter, University of Illinois.

No nominations being made from the floor C. J. Rowland, Pennsylvania State College, moved that the nominations be closed and that the Secretary be instructed to cast a white ballot for the nominees. The motion was seconded and approved and the ballot so cast.

Immediately after his election to the President's office J. L. Dohr took the chair and expressed his appreciation for the honor conferred upon him.

Professor Himmelblau reported briefly on the International Congress on Accounting which he and H. R. Hatfield, University of California, attended in July, 1933 as delegates of this association.

REPORT OF SECRETARY-TREASURER

On January 1, 1933 the Association had 598 members. During 1933, 18 new members were admitted and 24 applications for membership to begin in 1934 were approved.

Resignations and drops during 1933 were unusually large.

| | |
|---|---|
| 42 members resigned owing dues of.... | $ 76.00 |
| 51 members were dropped owing dues of | 408.00 |

SUMMARY OF MEMBERSHIP

| | |
|---|---|
| Members January 1, 1933 | 598 |
| New Members for 1933 | 18 |
| | 616 |
| Members resigned and dropped | 93 |
| Members December 31, 1933 | 523 |
| New members for 1934 | 24 |
| Members January 1, 1934 | 547 |

Although the Association has lost members and subscribers during the past few years, it has not suffered a decrease in its net worth. The decrease in expenses has followed the decrease in income so closely that it has not been necessary to encroach upon surplus. In fact the Association has even this year been able to show a slight increase in its net worth.

CHAS. F. SCHLATTER
*Secretary-Treasurer.*

REPORT OF AUDITING COMMITTEE

AMERICAN ASSOCIATION OF UNIVERSITY INSTRUCTORS IN ACCOUNTING:

In the discharge of our duties as members of the Auditing Committee we have made a detailed examination of all accounts and records of the Secretary-Treasurer, Professor Charles F. Schlatter, for the year ended December 31, 1933.

We are pleased to report that the records were found to be accurate, complete, and in good order. All cash received appears to have been properly recorded and deposited in the bank, and all disbursements appear to have been made for Association purposes and to be supported by proper vouchers.

Subject to the comments below, we certify that, in our opinion, the accompanying Balance Sheet and Statement of Income and Expenses correctly set forth, respectively, the financial position of the Association as of December 31, 1933, and the operating results for the year ended on that date.

It will be observed that while adequate provision has been made for possible losses on receivables, no allowance for depreciation of office equipment has been recorded. This latter asset is already stated at a very conservative value and any theoretical depreciation would be negligible. All other items in the statements are self-explanatory.

(Signed)
EDWARD J. FILBEY
H. H. BAILY
G. E. LUKAS
Certified Public Accountants,
Auditing Committee

Urbana, Illinois
February 23, 1934

*The attached statements have been abridged by the Editor*

BALANCE SHEET—DECEMBER 31, 1933

ASSETS

| | |
|---|---|
| Cash in bank | $ 822.33 |
| Building and Loan Association notes | 800.00 |
| Building and Loan Association paid-up stock | 300.00 |
| Dues receivable, less reserve for bad debts of $426.00 | 352.00 |

| | |
|---|---|
| Advertising accounts receivable | 138.75 |
| Subscription accounts receivable, less reserve for bad debts of $20.00 | 21.24 |
| Accrued interest on investments | 4.23 |
| Office equipment | 22.00 |
| Total assets | $2,460.55 |

LIABILITIES AND NET WORTH

| | |
|---|---|
| Accounts payable | $ 813.83 |
| Unearned dues | 120.00 |
| Unearned subscriptions | 215.25 |
| Total Liabilities | $1,149.08 |
| Net Worth: | |
| Balance December 31, 1932 | $1,306.61 |
| Net Income, 1933 | 4.86 |
| Total liabilities and net worth | $2,460.55 |

STATEMENT OF INCOME AND EXPENSE
YEAR ENDED DECEMBER 31, 1933

| | |
|---|---|
| *Income:* | |
| Dues | $2,104.00 |
| Subscriptions | 822.46 |
| Interest on investments | 68.67 |
| Advertising | 406.25 |
| Total income | $3,401.38 |
| *Expense:* | |
| Compensation (Editor and Secretary) | $ 500.00 |
| Accounting Review | 2,026.81 |
| Convention | 4.00 |
| Stationery and postage | 219.22 |
| Clerical help | 222.40 |
| Exchange and check tax | 3.46 |
| Accounting research council | 41.63 |
| Loss on bad debts: | |
| Dues | 350.00 |
| Subscriptions | 17.00 |
| Auditing fees | 12.00 |
| Total expense | 3,396.52 |
| Net income | 4.86 |

REPORT OF THE COMMITTEE ON RESOLUTIONS

The Committee on Resolutions presented the following for adoption:

*Resolved*, that the members of the American Association of University Instructors in Accounting extend to the Philadelphia Committee on Arrangements their appreciation and thanks for the work of the Committee in promoting the success of the 18th Annual Convention of this Association, and, that the Secretary be instructed to send a copy of this resolution to the Chairman of the above mentioned local Committee.

*Resolved*, that the members of this Association take this opportunity to express their appreciation and thanks to all the Officers of the Association and to the Chairmen and to the members of the various committees for their efforts in behalf of the Association during the past discouraging year.

*Resolved*, that the American Association of University Instructors in Accounting in convention assembled at Philadelphia in December, 1933 go on record as approving the ratification by the Senate of the United States of the "1928 Rome Convention for the Protection of Literary and Artistic Works," on which the International Copyright rests; And, that the Secretary of this Association be instructed, to write to the Secretary of State urging the early presentation of the "1928 Rome Convention" to the Senate of the United States for ratification, and also urging the passage of the necessary amendatory legislation embodied in Senate Bill 5, 1928.

*Resolved*, that the Members of the American Association of University Instructors in Accounting approve the action of the officers of the Association in appointing a representative and advisory committee to serve on and coöperate with the Joint Committee on Municipal Accounting, and that the members of this Association are urged individually, to coöperate with the above mentioned Joint Committee and to work for both legislation and the creation of public sentiment in favor of improved governmental accounting procedures, particularly with respect to:

(a) the selection on a merit basis of officials keeping or supervising the accounts and finances of governmental units

(b) the payment of adequate salaries to those charged with keeping and supervising of accounts and finances of governmental units

(c) the establishment of reasonable tenure of office for such officials

(d) the adoption of proper classification and systems of accounts

(e) the adoption of compulsory annual audits of all local governmental units and including all funds in control of such units.

Your Resolution Committee desire to present the resolutions attached hereto for your consideration and approval.

Respectfully submitted,
(Signed)
W. A. Fiske
L. L. Briggs
Charles J. Rowland
Committee on Resolutions.

# BOOK REVIEWS

*The Economics of the Recovery Program.* Joseph A. Schumpeter, et al. (New York: McGraw-Hill Book Company, 1934. Pp. xii, 188. $1.50.)

According to its introduction this publication "may be best described as a little handbook of, or guide to, the main ideas underlying the policy of recovery and the main arguments about it." The authors assert and, indeed, maintain a non-political attitude which is neither reactionary nor radical, though they are far from "believing that nineteenth century individualism is the summit of wisdom for all times" or that inflation is a "progressive measure" and we are reminded that "serious socialism has always stood for what is known as sound money." However, the authors are not interested in names, but only in that type of professional criticism which seeks the plain truth.

The first essay, "Depressions," by Jos. A. Schumpeter, analyzes briefly the crises of 1825 and 1873 and concludes that business adapts itself to the new state of things created by the previous prosperity. But, depressions are "moulded and made worse by the forces not inherent to the working of the economic engine as such." Indeed, the only thing that makes the present crisis fundamentally different from those of 1825 and 1873 is the fact that non-economic forces now play the dominant rôle in the drama. Consequently "we face not merely the working of capitalism, but of a capitalism which the *nations are determined not to allow to function.*" Yet certain lessons are drawn from these three comparable depressions, e.g., the problems of today are not unlike those which have previously confronted the world; in the past recovery came of itself, thus demonstrating the recuperative powers of our industrial system; there is a presumptive case for the contention that "recovery is sound only if it does come of itself." And, finally, that remedial measures which work through money and credit are dubious. However, remedial measures of the right sort are not inconsistent with this view.

Dr. Schumpeter's conclusions appear to be sound but they do not grow out of his previous discussion in a convincing way. In the following section, Dr. Chamberlain's "Purchasing Power," clarifies several popular misconceptions. Thus, "an increase in money 'purchasing power' does no more than to exploit one class at the expense of another unless accompanied by an increase in goods purchasing power." Again, a policy favoring consumption as against investment only fosters employment in the retail trades while discouraging it in the capital-producing industries. And again, an increase in consumer purchasing power "will not, nor should not, prevent the fall of profits in those sections of industry where overexpansion has taken place." Finally a high wage rate is not identical with a high total volume of purchasing power in the hands of labor. Such fundamentals cannot be too often nor too much stressed.

In his discussion, "Controlling Industry," Dr. Mason does service of a high order when he points out that ". . . these codes and agreements may have established vested interests extremely difficult to dislodge." Not only may, but will, if these interests are the typical alleged "friends" of the capitalistic system! Moreover, the codes provide, in some cases for restriction and proration of output and these constitute monopolistic practice designed to raise prices. Again, "the setting of prices necessary to cover in full overhead costs would only lead to a further and disastrous shrinkage of output." Obviously, certain code provisions, and practices which they permit, constitute a menace to recovery. This brief chapter has vitality and much unpleasant truth.

Under the title "Helping Labor," Dr. Brown points out that "unemployment occurs fundamentally because specific parts of the economic mechanism get out of line." Hence, public works are not a panacea for recovery, though they may help if their direction is right and application timely. Higher wages cannot be brought about by artificial means and neither can the cause of organized labor be so promoted and it does not appear likely that the general run of trade union leadership will be able to avoid the delusion of the artificial.

In his chapter, "Higher Prices," Dr. Harris warns that monetary measures designed to hasten recovery are popular because they seem simple. But an easy remedy for a depression will bear watching. If higher prices are wanted, they can be had by (a) restricting production; (b) by transfer of purchasing power from non-spenders to spenders and (c) by the creation of additional purchasing power. The Administration has relied upon the first two, holding the other in reserve. But it is obvious that purchasing power transferred by recent legislation may be diverted into channels which will not raise prices and so defeat itself. After all, higher prices are but a means to an end which can be achieved only if confidence is not destroyed and production costs not increased. The Hoover effort to stop the fall of prices failed but the Roosevelt Administration has more powerful weapons and therefore more perilous. Some of these have been utilized. Thus the Administration abandoned the gold standard and it has resorted to the purchase of gold with dollars with the intent of cheapening the latter. But inflation could have been achieved without either and devaluation need not have been the result. Increased reserves resulting from devaluation have something to do with prices, but it does not follow that Mr. Warren is right in his idea that the price level is determined by the dollar volume of our gold reserves. Certainly the dollar price of sterling is influenced by other factors than the price of gold and devaluation which under-values the dollar abroad can only be justified, if it is effective in raising prices at home. All of which is an experiment that will prove very costly even if it succeeds in bringing about the essential equilibrium of prices and costs.

The able chapter by Dr. Harris reads well to an economist, but it is rather heavy for the American general reader who ought to study it. Indeed, monetary economics cannot be simplified sufficiently for the general reader without danger of over-simplification. Dr. Leontiff's chapter, "Helping the Farmer" outlines

the economics of that problem as well as possible in so brief a space and the reviewer commends it to the industrialists, capitalists and labor leaders of the country. Finally, there comes Dr. Taylor's chapter, "Economics versus Politics" constituting an able concluding essay in which he points out that our problem is that of "imposing new and more effective all-around limitations upon the future power of every group to exploit others . . . ." He makes it clear that economic *laissez faire* has been the victim of its alleged friends and, in particular, has suffered from the efforts of organized minorities to get control of the government for their own ends. Obviously he would agree with Clay, the British economist, that *laissez faire* has really never had a chance. The political activities of both capital and labor, rural and urban, has brought about its downfall and this event has made the present crisis something more than a typical depression, a point made by Dr. Schumpeter at the outset.

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*The Federal Securities Act Manual.* George C. Thorpe and Challen B. Ellis. (Cincinnati: The W. H. Anderson Company, 1933. Pp. iii, 422.)

The subtitle of this book states that it is "A Treatise Based on the Federal Securities Act of 1933 and the Corporation of Foreign Bondholders' Act, 1933." Both authors are members of the bar, and it is a manual of legal, not accounting, procedure. In general structure the work consists first of 26 chapters, in each of which a section of the Securities Act is given, to be followed by explanatory notes, rules of procedure applicable to the section, Federal Trade Commission rules, and items from the record of the passage of the bill through Congress. Chapter 27 is entitled "Independent Public and Certified Public Accountants under the Securities Act," and Chapter 28 relates to the Corporation of Foreign Bondholder's Act. The remaining 100 pages of the book consist of forms, including the registration statements prescribed by the Commission, and a host of court forms.

The preface intimates that though the act "marks a novel extension of federal power . . . its cardinal principles and provisions are by no means new," and that in decisions and procedures of the past we may hope to find the key to probable results of future actions under the law. No sign appears here of the rising tide of excited discussion and anxiety which has since gathered around the liability provisions.

The accounting reader will naturally turn to Chapter 11, dealing with §11 of the Act, and also to Chapter 27 on the position of accountants under the Act, written by Mr. Frederick A. Tilton, a C.P.A. and former Assistant Postmaster General. In the former chapter, after citation of the Act and a summary of the section, occurs a paragraph entitled "Sources of the civil liability law," in which we are told three times over, once in the author's own words, once in those of the Committee of Banking and Currency, and once by the House committee, that the Act is copied from or similar to the English Companies Act. This similarity is insisted on all through the main text, and only in a footnote (p. 104) is there notice of a difference between the two Acts in regard to the liabilities imposed. The substantial differences pointed out in the Journal of Accountancy (January, 1934) do not appear in this text.

The reports of the committees of Congress are quoted at some length, with the observation that, under a Supreme Court decision, we may expect to see them utilized in construing the Act. From these quotations it is indeed pretty plain that Congress did intend to place these responsibilities and penalties upon all and sundry who had a hand in the issuance of securities which afterwards went wrong; and everyone acknowledges that the situation needed something to be done. But it is also clear from the reports that there was not present in the minds of the legislators a very exact discrimination between different degrees of negligence or guilt, nor a clear perception of the chain of connection between (1) the misstatements alleged, (2) the loss complained of, and (3) the penalty.

Chapter 27 consists of a brief exposition, apparently for the benefit of lawyers, of the nature and functions of public accountants, and of the steps taken in recent years by the Stock Exchanges and the organizations of public accountants to make these functions more effective and more serviceable to business.

Whether or not the liability clauses will be amended, it is clear that the general substance of the Securities Act is a desirable addition to our statute law, is with us to stay, and will have considerable influence on the work of the accountant. Anyone who needs guidance on points of procedure under the Act, and on its probable interpretation in the courts, will find much assistance in this book. For discussion of the wisdom or otherwise of the public policies implied in the Act, they will have to look elsewhere.

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"*Formblatter für den Jahresabschluss.*" Kurt Schmaltz. C. E. Poeschel Verlag. (Stuttgart, 1933. Pp. viii, 76.)

The scandals that accompanied the collapse of several large concerns in 1931 resulted in new legal provisions for the setting up of financial statements for German corporations. This pamphlet discussed the uniform statements that have been worked out for industrial corporations, for commercial and for mortgage banks, savings institutions, railroads, streetcars, coöperatives and building and loan institutions. Needless to emphasize that a comparison of this trend to uniform accounting practices with the efforts made along this line in this country should prove of interest to the reader of this journal.

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*The Investor Pays.* Max Lowenthal. (New York: Alfred A. Knopf, 1933. Pp. ix, 406. $2.50.)

On March 18, 1925, the Chicago, Milwaukee and St. Paul Railways Company was placed in receivership. On November 20, 1926, it was reorganized. Mr. Lowenthal's book tells what happened between these two

dates. It is not a very pleasant story. The railway was once one of the strongest in America. Then, in a fit of megalomania, it built a line to the Pacific for which there was no traffic. This original mistake was aggravated by an unsound financial policy which piled up a topheavy structure of bonded indebtedness. The result was years of decline with a lethargic management which eventually drifted into receivership. The largest stockholders had originally been the Rockefeller, Armour, Harkness and E. B. Smith families, who virtually nominated the board. When bad times came these families—with the honourable exception of the Harkness interests—sold out their securities but continued to monopolize the directorships. The railway's bankers were Kuhn Loeb and Company and the National City Company. Its sponsorship was therefore of the very highest. Nevertheless, the story which Mr. Lowenthal has to tell cannot avoid making a very painful impression.

Before the receivership there were transactions which do not speak highly of the board's conceptions of trusteeship. After the receivership the bankers are the villains of the piece. The receivership was arranged with a "friendly creditor" before it was necessary, in order that the petition might be granted by a friendly judge and the railway's own president appointed receiver. The bankers nominated committees to represent the different categories of shareholders, the committees containing, in fact, few holders of the securities and still fewer persons who were not in one way or another beholden to the bankers. With the help of these committees and of the most eminent and respected legal firms in New York, "deposit" of the securities was obtained by extra-legal threats of discrimination in the final reorganization against non-depositors.

The final reorganization was doubtless equitable to the various classes of security holders. But in the process of bringing it about the vast majority of them had no way of expressing their views or wishes, other than the purely negative one of depositing their securities under a deposit agreement which put them entirely into the hands of the bankers. As Mr. Lowenthal shows very convincingly, the average investor had no option but to agree. The bankers, being first in the field and in agreement with the receiver, held the dominant position. And who were the bankers? They had none of the road's securities. Their only connection with it was that of firms who had made large profits out of selling its securities (on one occasion they made a profit of 5 per cent, on $25,000,000 in one week). Whom did they represent? A group of men who had brought the railroad to receivership and had sold out their holdings of its securities. The bankers and their lawyers used every legal device to head off genuine security-holders and to avoid Governmental inquiry. Their fee of $1,044,000 certainly seems excessive. The additional expenses of some $5,000,000, including large payments for nominal services to most of the large financial institutions and corporation lawyers of New York, were also on the generous side. The whole business is most discreditable.

Mr. Lowenthal bases himself throughout on official documents. In spite of this, his book is fascinatingly interesting; to use a *cliche*, it is "as exciting as a novel." All those who are interested in the pathology of Big Business should certainly read this book.

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*Corporation Finance*. Henry E. Hoagland. (New York: McGraw-Hill Book Company, 1933. Pp. xix, 463. $3.50.)

Professor Hoagland has arranged the fifty-four short chapters of his book into suitable subdivisions of which Part I, The Corporate Concept, includes four chapters; Part II, Corporate Securities, nine chapters; Part III, Promotion, eight chapters; Part IV, Internal Financial Control, eleven chapters; Part V, Expansion, ten chapters; Part VI, Failure and Reconstruction, seven chapters, and Part VII, Social Control, six chapters. It is, therefore, evident that the book covers the usual phases of the subject and has, in addition, a section on social control. Apparently no aspect of the subject has escaped the scholarly notice of the author. Indeed, he gives evidence of a knowledge of corporation finance which much exceeds the material set forth in the text. But the latter is often presented in the form of enumerated condensed statements which lose much of their vitality when so tabulated. If these had been broken up, expanded and illustrated either by hypothetical material or historical instances the work would have been materially strengthened. One may assume that the author had in mind the use of a book of materials, but if so, it may be observed that no such supplementary material makes up for lack of citation to actual cases and instances in the body of the text or in footnotes. Indeed, the latter is, perhaps, the most valuable feature of Dewing's Financial Policy of Corporations.

Dr. Hoagland's book has the merit of stating clearly essential facts often obscured in more elaborate treatises. Moreover, he enlivens his writing with a certain amount of wit some of which is rather ironical. Thus, referring to the Sherman Antitrust Act, he states that it is "couched in language so clear and simple that only lawyers and judges could possibly misunderstand it."

In the treatment of the subject matter there is no material departure from conventional points of view. However, attention may be called to the fact that in his classification of unsecured bonds he includes joint bonds, receiver's certificates, assumed bonds and guaranteed bonds, though he is careful to point out that these are often of a hybrid variety, having a specific lien. In discussing direct operating expenses he includes repairs and depreciation and then, passing to other charges that must be made in order to determine profits, he includes valuation reserves. There is no objection to this arrangement so long as it is properly explained, which is not the case here. Again, in duscussing preferred stock, it is said that if the stock is non-cumulative as well, its holders should have a definite interest in the determination of current earnings as contrasted with accumulated earnings. Very true, but it does not follow that "its rights to dividends under such circumstances are determined by this definition" of current earnings. The Wabash decision leaves the matter open to the directors,

even where the dividends are earned in whole or in part, unless the contract makes the declaration of a dividend compulsory to the extent they are earned. The discussion of the advantages of diversification might well be reconsidered in the light of the discussion in Chamberlain & Hay: Investment and Speculation Ch. V. The reference to privileged subscriptions as obligatory subscriptions is not without a certain clever insight and the discussion of the third period of the combination movement is quite valuable. Gerstenberg's preference for the term circulating capital rather than working capital appeals to Dr. Hoagland and he calls attention to the evils of excess circulating capital, but here is another opportunity for expanded treatment which should have been seized.

There are few signs of a critical attitude until one comes to the discussion of investments trusts, but this deficiency is somewhat offset by the useful discussion of Social Control, in Part VII, where he points out that "A careful survey of some laws on the subject of corporations makes one wonder whether the framers thereof are anything more than tools of the interests they serve." Some of the problems of corporate control arise from weaknesses which are traced to stockholders while others arise from the lack of information together with the fact that the management has information first. But here also the weaknesses of financial management are presented in tabulated form, with consequent loss of vitality. The same may be said of devices for minority control. As for the agencies for social control the author finds little in American experience that offers much in the way of a solution of the problem and his book went to press before the Federal Securities Act became law. A brief treatment of British and German methods of control adds much to the value of this section. He then turns to "Rationalization and Stabilization" without making clear just what rationalization is to mean and without coming to very definite conclusions, though it seems that he looks upon relief from this source with little hope. Indeed, we appear to have no objectives for we "have all been driving so fast that many of us have never thought where we are going."

Apparently the author regards the present time as a period of transition from *laissez faire* to something else and, while he does not welcome the uncertainties of the latter, he is quite convinced that the former offers no hope, since "losses are not adequate penalties for management inefficiency, because so many others, without fault of their own, are asked to bear the burdens of the mistakes of management." Competitive legislation by states, unintelligent and uninformed security holders who buy stock not to hold but to speculate, the obstacles to appeal to the law, these and other problems are so serious that solution of evils growing out of the prevalence of the corporation seems hopeless.

But he suggests four alternatives. "Rugged individualism" offers nothing since we give it no more than lip service. The adoption of a "Second Russian dictatorship" is not likely to come about "at least until it has been demonstrated that the defects of our present system are beyond repair." The occurrence of some "ingenious scheme that effect the salvation of our economic souls without punishing us for our sins" seems highly improbable because of our suspicion of a "gift horse." Finally, a continuance of "our perpetual inventory of our economic system" so that the causes of our past mistakes and successes can be made the basis of future plans which should give due consideration to posterity.

Since the part on Social Control is by far the most valuable portion of the text, it is to be hoped that the author will find opportunity to revise it as his ideas become more definite, for no other text on the subject provides adequate discussion of this highly important subject. Incidentally, the book is very well done from the point of view of printer's art.

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*The Development of Economics.* William A. Scott. (New York: The Century Company, 1933. Pp. xii, 540. $4.00.)

Professor Scott tells us in the preface that his book is "the outcome of the author's experience as a graduate student and as a teacher of graduate students for a period of forty years." He is aware that a student may readily become lost in the mass of literature relating to the subject and has sought to overcome this difficulty by "grouping the topics to be studied around the development of the Classical Political Economy of England by considering first, the background of that development in the economic life and thought of the preceding period; second, the development of the Classical Political Economy itself; third, its early critics; and fourth, attempts to reconstruct the science in the post-classical, including the contemporary, period, and critics of these attempts." Such is the plan of the book and it should be said at once that Professor Scott has carried it out with great success, thereby providing a much meeded text superior to anything hitherto available.

In general, Professor Scott allows the writers of a given school to present their own ideas. He fills in the background of economic and social conditions, but does not as a rule present his own ideas of a school or group. Criticism of the ideas advanced by a school is sometimes presented by contemporaries of that school, sometimes by the author himself and sometimes not at all. Thus one finds no exposition of the defects of Adam Smith's views except that which appears in the material relating to his contemporaries or successors. This method does not always suffice, for attention may not be brought to really vital errors until much further along in the discussion and the realization of these may thus lose its effectiveness. The failure of Smith to work out a really sound definition of wealth and adhere to it was undoubtedly the chief source of confusion in his ideas, but this fact is not brought out. The position of Ricardo is clearly outlined by well-chosen selections from his writings, but the reader is left to work out for himself the respects in which the thought of Ricardo was superior to that of Smith. It is not even made clear just how much further along Ricardo carried the theory of rent which he received from Malthus and West and the real inwardness of his theory of value is not set forth. In Chapter X, Professor Scott deftly weaves into one

stream the various contributions of thought that developed in the period from 1815 to 1848. And he makes it clear that new economic forces were then at work producing new economic ideas of such contributors to theory as Bentham and the other "Philosophical Radicals" as well as Malthus, Richard Jones and Senior. The metamorphosis of "The Wages-fund Doctrine" is discussed but just what was wrong with it is not made clear.

The discussion of J. S. Mill gives an excellent conception of his place in the development of economic thought, for Mill, like Smith before him and Marshall afterward, carefully appraised economic ideas from the point of view of the Classical School and thus consolidated the position of the School. But Mill retained Smith's conception of unproductive labor and in this as well as other respects he failed to correct the by-paths taken by economic thought which only tended to hinder and complicate its development. After all there is not much point in bringing out Mill's views of production, distribution, etc., without showing the respects in which they represent corrections of or adherence to errors of his predecessors and their twists of thought or consequent damage. In his able presentation of Mill, if Professor Scott had but set forth the evolution of ideas as does Cannan, desirable results would have been achieved. In other words, if he had taken each contributor's thought as a whole and shown what he had to begin with and where he left the subject, the value of the book as a text would have been materially advanced. As it is, he leaves this to the instructor who uses the text and for this solution of the problem, there is, of course, a great deal to be said.

At the conclusion of Chapter XII, there is, for the first time, an appraisal of a particular economist or school. Here, in his treatment of the Nationalists, an appraisal is made and it adds materially to the value of the chapter. This writer has only praise for the choice of materials selected, for they well set forth the ideas of the authors. Nor is there criticism to be made of the skill with which they are connected, for the work is remarkably smooth throughout.

When he takes up the Old Historical School, Professor Scott makes its representatives speak for it with much skill and to the effect that Classical Economics was not faulty in itself, though it had distinct limitations. Hence it became the purpose of this School to to build up the science in these respects and thus a place of growing importance was made for both pure theory and generalizations based upon historical research. Further dissent from Classical Economics and criticism of it in certain respects is brought out in the chapter on The Optimists wherein exceptions taken by Cary and Bastiat to Ricardian ideas of distribution are brought out. The criticism of "Smith and the economists" and their premises is continued by discussion of such dissenters as Sismondi, Saint-Simon and the Associationists, Owen, Fourier, Blanc and Proudhon. The growth of dissent broadens into constructive philosophy, the basis of modern socialism which is traced from Smith to Marx. But Marxian thought is given a relatively small place, considering its latter day permutations.

Then comes an excellent chapter—"The Science in the Early Seventies"—a summary of vulnerable points in the doctrines of the Classical School not brought out in the text up to that point and yet absolutely essential. There follows the chapetr, "Some Characteristic Features of the last half Century" in which significant changes including industrial technique, development of the credit system, the business economy, readjustment to changing conditions, The World War and changes in the field of thought are discussed, thus forming an essential and substantial background for the remainder of the book.

As for this remainder, the position of the Austrian School bulks large. Menger, Von Wieser and Bohm Bawerk come in for fairly full discussion which is followed by a chapter on the application and restatement of Austrian doctrine along with another on the "Criticism of the Austrian Doctrines." The former has the merit of including Wicksteed and the latter definitely sets forth the views of the author for he says (p. 418) "The marginal utility theory may not be, and probably is not, the last word on the subject, but it will continue to hold its ground until something better is found to take its place, and then it will probably be found that this theory has been an important aid in finding something better."

In a sense it may be said that the whole of the book from Menger on is devoted to Austrian economics for, following the chapter of "Criticism," comes one on Clark of whom he says, ". . . in the field of value he developed a theory in fundamentals like theirs." Unfortunately the exceptionally able chapter on Clark lacks an appraisal of his place in economic thought. Professor Scott then passes to Marshall to whom he devotes a shorter chapter and a much less satisfactory one. Perhaps this may be traced to Marshall's lack of complete conformity to the Austrian tradition. At any rate the author finds occasion for criticism of Marshall while remaining quite silent respecting the deficiencies of Clark. The latter reinforced Austrian doctrines and extended their applications, while the former used them as a means of building up and fortifying the Classical position. Indeed, according to Professor Scott, ". . . the entire group of problems to which the Austrian addressed themselves have not received adequate consideration by Marshall."

Turning to "Social Value Theories" Professor Scott gives consideration to that developed by B. M. Anderson, Jr., but he finds nothing in Anderson's theory which the Austrians have not sufficiently taken into account. Walker's theory of profits is presented but not criticized and the same is true of Macfarlane's. Room is also found for "Theories of Money and Credit" the essence of which is the quantity theory of money as elaborated by Fisher, Keynes and Kemmerer. But Professor Scott feels that they have not made the theory impregnable and so he finds reasonable security in the position taken by Laughlin and himself. Unfortunately this position is not analyzed and the clarifying of the subject by Cannan and Hawtrey is not taken into account. Professor Scott finds vital defects in Phillips' theory of the expansion of bank credit, but here, too, there is a failure to consider restatements of the theory. Finally Profes-

sor Scott comes to the "Revolt against 'Orthodox Economics' during the last half-century," in which he includes the New Historical School of Schmoller, Cliffe Leslie, Ingram and Ashley, apparently accepting their views. The institutionalists, led by Veblen, find a place and the Statistical Economists, represented by Mitchell, are presented as "a variant of institutional economics."

The general conclusion respecting this work must be that Professor Scott finds in the contributions of the Austrians the substance which converted Classical Economics into something of lasting vitality. Indeed, one drops the book with something of a feeling that the latter has become the tail which wags the dog. Apparently not even the fine work of Marshall succeeded in putting Classical Economics back on the road where its founders had placed it; hence it must continue on in the direction given it by the Austrians. In any event, one must feel grateful to Marshall for his attempt to restore the vitality of the English tradition in economics and also for the success with which he appraised the limitations of the German contributors who, apparently, have dominated the thinking of Professor Scott. Incidentally here is a book which those recent critics of Economics as an unsubstantial and undependable body of shifting ideas should read with care and reflection, for it ably sets forth the diligent labors of a long series of able thinkers who have striven with a considerable measure of success to place the thinking on economic problems on the level of a science.

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*Contemporary Banking*. H. Parker Willis, John M. Chapman, and Ralph W. Robey. (New York: Harper & Brothers, 1933. Pp. xv, 826. $3.75.)

According to its introduction this volume is the result of an effort to find "a satisfactory text for introductory classes in Banking, or Money and Banking." But several factors have "combined to increase the perplexities of the case" among them, "only a moderate approach to unanimity of opinion with respect to the content of an 'introductory course'." Observing that many instructors still prefer to take up money at the beginning, while others deal with it "as a factor merely in the general problem of developing a system for the exchange of goods," the authors have sought to develop a book which will supply "the needs of the latter type of instruction."

Its forty-four chapters form no separate subdivisions, but they cluster around exchange and the banking process, banks and their organization, control of bank operations, banking in relation to the central bank, the money market and the business cycle. Necessarily bank credit comes in for a considerable place but it cannot be said that the subject of money has been sufficiently treated to eliminate the need of a separate course developed around a text such as Bradford's. Nevertheless, the book has unusual merit. It is not merely a well-edited assemblage of the best features of other texts, for it is built along original lines with the whole treatment evolving step by step from an underlying philosophy of banking presented with vigor and thoroughness from a social point of view with stress on economic fundamentals. The essence of the underlying philosophy may be said to lie in the bank's "duty and function of preventing any deviation from . . . balanced production and balanced exchange," an end to be achieved by producing "'liquidity' in the business and productive life of the community."

The authors, in adhering to this central thought, have not failed to bring out those respects in which banking has tended to develop away from its "duty and function," nor have they failed to clearly indicate demands made upon the banking system which cannot be fulfilled. Thus attention is called to the fact that "the law recognizes no distinction between large and small banks." Chain banking has been found wanting in a number of essential respects, but there is nothing in branch banking that is "likely to produce the monopoly conditions so much feared" by those who oppose it. The divergence of state and federal control of banking has been "the basic obstacle to progress," while "the exaggeration of given industries through the allotment of overmuch credit . . . is a primary cause of difficulty and hazard." Nevertheless, the bank has a definite duty to the securities or investment market. But the hazards of performing it are not overlooked, for it is observed that "the bank failure ratio is always high in a country of independent small banks," though they are not chronic under any except the independent type. Moreover, the system is weak with respect to reserve requirements and "it would seem that the time has come to study a reserve system based upon turnover." Diversification, on the other hand, offers little in the way of increased strength and "permission to carry on savings deposit business through commercial banks was a blunder of the first magnitude," hence a reserve of 3 per cent is far too low for soundness.

"Efforts to advance prices cannot successfully originate with the bank, but must come from the outside," hence the bank "is not able to control or direct economic affairs, nor is it able to keep something called 'credit' outstanding or in use as it sees fit," for an "overinvested bank is . . . an 'inflated' bank and a bank that is necessarily in grave danger or may be so at any time." Progress toward adherence to sound banking practice has been defeated by "an injurious competition between Congress and the state legislatures." But, after all a great deal should not be expected of the law, for unless banking "should succeed in developing itself more largely into an occupation with definite codes of professional conduct and in throwing off the purely business conception which of late years has so largely damaged its development," there can be no assurance of progress. The deficiencies of public regulation are shown in many ways but in none more effectively than in "the inadequacy and inefficiency of the national receivership system."

There is a much-needed chapter on bank examinations and it is observed that, if their object is to prevent failures, "the final answer as to the utility of the system seems to be rendered when we recall the statistics for the failure record of recent years." In the chapter on "Interest and Discount" it is said that much of the infla-

tion which took place in the securities market in 1929 might have been avoided, if the central bank had adopted a more aggressive policy and increased its rates soon enough. Here also reference is made to the flow of "surplus funds of interior banks" to the call loan market in New York, a view questioned by Beckhart."[1] In view of the connection of Dr. Willis with the volume, the chapter on Central Banking in the United States has peculiar interest. Here we are told that "the money market . . . , even under the reserve system, came to revolve around the stock markets as its center," a tendency which defeated the development of a real money market. Recent legislation is frankly discussed with the conclusion that it has brought "a change in American banking legislation designed to work precisely counter to all that had been done" during the fifteen years preceding the enactment of the Glass bill in June of 1933. The view that "a 'qualitative theory' of bank credit must be accepted as the result of current experience in banking" rather than a quantitative theory, commits the authors with respect to Federal reserve policies in controversy prior to 1929.

Of interest to accountants is the reference (p. 81) to a bank's debt to its stockholders for capital paid in, surplus, undivided profits and reserves. Again, "there is not today in the United States any actually recognized or uniform plan of bank statement and accounting arrangement designed to promote it." On p. 88 it is also said that capital may be regarded as a buffer for the absorption of losses, even though it is something owed to stockholders.

There are but few errors, among them an omission on p. 203. Taken as a whole this volume, with its Outline of the Banking Course in Columbia College and the Questions and Readings, constitutes an important addition to the texts now available. While the treatment is too advanced for beginning courses in small colleges, it is welcome collateral reading for them, and an excellent text for larger colleges and universities. It is thorough, comprehensive and substantial. Moreover, it includes material often omitted, essential to a well rounded treatment, in that economic fundamentals are never sacrificed in the interests of a so-called commerce course. There is vigorous adherence to sound banking tradition as it has come down to us and an effort to keep banking where it should be rather than accept prevailing tendencies.

E. A. KINCAID

*University of Virginia*

*Taxation Issues.* M. Slade Kendrick. (New York: Harper and Brothers. 1933. Pp. xii, 147. $1.00.)

This is the third of a series of small books on current economic problems edited by Professor Paul T. Homan "I have emphasized," Professor Kendrick tells us, "those problems in which I thought I had something to say." The book makes no pretense, then, to comprehensive treatment. It deals only with a number of selected topics, and treats of these only with regard to certain aspects. For this reason it is likely to prove more suitable for use by those who already have had some introduction to taxation problems. And these readers will find in it much that is fresh and suggestive, with little that is commonplace. The style is simple and clear.

The first chapter considers "The Rising Tide of Taxation." The figures are analyzed by the forms of government—federal, state and local—and by types of government expenditure. There follows another statistical chapter on "The Quest for Revenue." In federal revenues the outstanding phenomena since 1913 are the swing from exclusive reliance upon indirect taxes (notably customs, and excises on spirits and tobacco) to large dependence upon income taxation (p. 27). This has, of course, placed more of the burden upon the wealthy. In state revenues, during the past two decades, the general property tax has played a declining relative part, while gasoline taxes, income taxes, and federal aid have taken up much of the slack. The statistical tabulation of state receipts (p. 30) is by large groups of sources, concealing much that is significant, and the rise of the state income tax receives little more than mention in the text (p. 34).

Local taxes account for more than half our burden, and here the general property tax continues to be the source of over 90 per cent of the bill. Accordingly, a chapter is devoted to this tax—the only one considered at length. Its notoriously faulty distribution is criticized; also the fact that it is on an "expenditure basis," —that is bears the burden of whatever expenditures remain to be met after other sources of revenue, more or less stable in rates, have been taken into reckoning. This residuary nature results in undue burdening of property during periods of rising expenditures, and also accentuates the cyclical fluctuation of land values (pp. 44–48). Kendrick proposes, among other things, that real estate should be taxed upon the basis of net rental, rather than upon its capital value.

A chapter on relations between state and local taxation follows. In the past two years the relation of the federal treasury to both state and local finances has become the more vital issue.

In a chapter on the shifting of taxes Professor Kendrick urges that "whenever the expenditure of the funds gathered by a tax can be ascertained, an account of the effects of this expenditure, if any, upon the supply curve or the demand curve of the relevant tax object, is a necessary step in the determination of the incidence of this tax." Thus a tax on gasoline tends to discourage its use, but if the resultant revenue is spent on improvement of roads, this encouragement to the driving of automobiles may have a counterbalancing effect on the demand for gasoline (p. 126). Both phenomena, Kendrick insists, should be regarded as part of the incidence of the tax. Yet we might have the gasoline tax without road improvement, or we might have road improvement that is financed instead out of general tax sources, or by loans. It is often pertinent to compare the incidence of a tax with the effects of a particular expenditure of its proceeds; nothing is gained, however, by combining the two phenomena as though they were the incidence of the tax itself.

In his concluding chapter, consistently with what has

[1] The New York Money Market, Vol. III, 5–9.

gone before, Kendrick urges that our tax system should be completely reconsidered with the purpose of applying the benefit principle more thoroughly. "Whenever the benefits arising from a particular governmental expenditure can be allocated to a particular tax source, that tax source should pay for this expenditure" (p. 137). Thus fire apparatus is for the protection of buildings and personal property; these sources should bear the cost, not land, upon which much of the burden falls today.

HARRY E. MILLER

*Brown University*

*Economic Cycles and Crises, an American Plan of Control.* William C. Schluter. (New York: Acorn Publishing Company, Incorporated, 1933. Pp. xi, 378.)

As stated in the author's preface, the book falls into three main divisions. The first surveys the factors which govern economic and social progress; presents a record of good and bad times in the past; attempts to throw light upon the relation between economic cycles and the economic trend; depicts the operations of the factors which characterize the business cycles and the shifting conditions that underlie human welfare; analyzes the influence of climatic changes on the business system; and describes the capricious character of factors shaping the course of business and economic activity. In the second division of the book, a general survey of changing business and economic conditions from an historical viewpoint precedes a critical examination of many of the theories which have been advanced to explain the phenomena of cycles and crises. The third division of the book presents the author's constructive program for stabilizing economic conditions, which he describes as "economic administration under Americanism."

The program involves the creation of numerous "institutes," also "federations" and a "national economic council." Four groups of institutes are recommended: institutes of industry (i.e. production), of commerce, transportation and communication, of banking and finance, and of accounting and prices. Each institute is to be invested with the legal authority to legislate industrial and commercial policies for the economic group it represents and also to supervise their execution by business management. In the opinion of the author, the American ideals of democracy and freedom are preserved because the institutes are to be created in the first instance by the industries they are subsequently to control.

All of the institutes in each of the four groups already designated are to come together to organize the federations and these federations are then to be combined into the national economic council.

The general nature of the program is well indicated by the following quotation (p. 249):

> All State governments would have to yield on all matters economic to the institutes and federations of institutes, which thus become the national democratic-republican form of economic government and administration. State and Federal political governments will be restricted to legislation and administration of social matters, such as education, public improvement, crime, police, etc., and the Federal political government must faithfully coöperate with the industrial government in facilitating its work and must stand as the final legal authority behind this scheme of economic administration.

The author is opposed to "national economic planning," which he regards as a political superstructure superimposed upon the economic system,—something very different, in his judgment, from his own program.

J. L. SNIDER

*Harvard Graduate School of Business Administration*

*Neue Deutsche Wirtschaftsführung.* H. Nicklisch. (Stuttgart: C. E. Poeschel Verlag, 1923. Pp. 87.)

This tract represents the creed of a well known German economist who applies the national socialistic doctrine to his philosophy of business organization. While he condemns the evil spirit of pure egoism and greed for profit he also rejects the planned economy of Soviet Russia. The private egoism is to be transformed into organic egoism, a conception the development of which occupies the geatest part of the pamphlet.

ROBERT WEIDENHAMMER

*University of Minnesota*

*Methods of Statistical Analysis.* George R. Davies and Walter F. Crowder. (New York: John Wiley & Sons, 1933. Pp. xi, 355. $3.25.)

Although the supply of books relative to elementary statistical methods is far from limited, this work of Davies and Crowder is deserving of a place with the better texts. Introductory courses in statistics for the business student and the student of social sciences should concentrate upon the fundamental methods of statistical analysis without attempting to present the more intricate statistical methods, which find little practical application in business. Davies and Crowder have been reasonably successful in preparing a book to fit this need. The important topics included in the conventional statistical course—averages, dispersion, time series analysis, correlation and index numbers—are treated in as simple and clear a manner as their nature permits.

The more complicated mathematical proofs are presented in footnotes and appendices, which simplifies the basic work of the text and at the same time permits further study for the mathematically minded student.

This text should fit the needs of the conventional course in statistics but is likely to prove of less value to the business man or the student in business colleges. For their purpose it would require supplementary material to show the application to business problems of the statistical methods which the book very adequately discusses.

RICHARD P. DOHERTY

*Boston University*

*Delaware Laws Affecting Business Corporations Annotated.* John Briggs, Jr. and Stewart Lynch (ed.).

(New York: United States Corporation Company, 1933. Pp. 474.)

This is a well organized and well indexed reference book on the corporation laws of Delaware, revised to October 15, 1933. Each section of the statute is annotated by reference to the same subject matter in earlier statutes and by brief digests of the cases bearing on the section.

The sections of most interest to accountants are as follows: consideration for stock (Sec. 14), holding own stock (19), reduction of capital (28), dividends (34, 25), loans to officers (36), mergers (59–64).

A. C. Littleton

*University of Illinois*

*Proceedings of the Fourth International Congress on Accounting.* (London: Gee & Co. 1933. Pp. xxix, 747.)

The papers and discussions of the most recent Congress on Accounting are noteworthy for their breadth of subject matter. Almost one-fourth of the book is devoted to non-accounting problems related to corporations, that is to regulation of utility companies and growth of corporate combinations. In this same category, although including more accounting problems, is the paper on holding companies and their subsidiaries. If to these be added the papers on international finance and on foreign exchange, it appears that the Congress gave approximately one-half of its working time to questions related social welfare and international relations.

The other half of the book deals more directly with accounting matters. Approximately 134 pages are devoted to auditors' legal responsibilities, and 214 pages are divided between such subjects as depreciation, machine accounting, and the serviceability of accounting.

Combines and cartels have grown rapidly in Europe of late. Their advocates have considered them a "first essential" in the movement for rationalization of industry. In fact rationalization might be described as a combination of scientific factory management with the merger of industry into large units or close-knot groups. The expected elimination of waste, facilitation of research, increase in labor efficiency, earning a reasonable profit, and other reasons explaining the spread of combines have a familiar sound to Americans.

These ideas, together with the data given in the papers regarding the extent of the movement, make one wonder if Europe is not approaching a period of "trust-problems" such as we had a generation ago. Apparently the falling prices and competition of the post-war depression is driving enterprises into protective alliances just as similar conditions did for us before the turn of the century. England has no special legislation on combines as yet and, to judge by the discussions following the papers, opinion is inclined to doubt the altruism of these "genuine attempts to improve trade."

Another paper reviewed the British statutory control over rates and dividends of privately owned public utility companies. It is of most interest to American readers to learn that control legislation in the last decade aims not only to protect the interest of both investors and consumers, but to make utility investments stable and safe in a way to compare favorably with government securities.

The principle followed is to place the investors and consumers on a partnership basis, as it were. The means employed is a sliding scale arrangement by which rates to consumers may be raised as dividends are lowered or dividends raised as rates are lowered. In some cases the proportionality of rates and dividends is specified in some detail. In the electrical power industry, for example, the dividend may be increased 5 shillings per cent for every $1\frac{1}{4}$ per cent the rates fall below the rate named in the statute; for every 5 shillings per cent of dividend above the statutory dividend rate, the price for service the next year must be $1\frac{1}{4}$ per cent lower. Excess earnings of railroads are applied to lower the service charges by a sliding scale. Water company earnings above seven per cent on common and five on preferred shares are used to create a dividend equalization fund until the fund amounts to one-tenth of the nominal capital.

The third paper in this group dealt mainly with the more or less familiar accounting problem of holding company accounting for subsidiary company earnings as earned or as declared in dividends. Not all of those who spoke on the subject were satisfied with the Company Act of 1929 as it dealt with holding companies. A plea was made for greater publicity of holding company affairs, reference being made to the new German decree and to the New York Stock Exchange regulations. A special point was made of the fact that wide holdings of large companies' stock meant that accounting statements were the only means of obtaining information concerning their operations and that for that reason secrecy regarding the company's affairs was quite out of place however it might be justified in the case of closely held stock.

In the papers and discussions of the more technical matters much interest was apparent in the developments of the last few years regarding professional responsibilities.

Under the new German law of 1931, accounting is subjected to definite and detailed regulation. Audits by qualified professional accountants are compulsory, detailed provisions are made in the decree for definite standards of balance sheet arrangement and value base and the qualifications of auditors are completely set forth.

In the discussions some doubt was expressed regarding the effectiveness in England of equally detailed prescriptions. Reference was made in contrast to the entire absence of prescribed details in the United States and Canada, and the opinion was expressed that here the financial statements were "clearer than any others," presumably as a consequence of the freedom to evolve ever higher standards.

The American paper on auditors' responsibility, as one would anticipate, analyzed the philosophy of the Ultra Mares case. In essence the case means that, except in instances of outright fraud, the auditor is not liable to strangers with whom there has been no privity of contract. "This," said Col. Montgomery, "represents an attitude of which we cannot be proud." But

if the auditor is to be liable to everyone under the sun, the financial responsibility would be more than any firm could face. The court, it was pointed out, had to choose between benefiting society by holding auditors financially liable for negligent errors and depriving society of much of the service auditors could perform by "the imposition of such an extensive and indeterminate burden" as to limit materially their activities.

The British presentation of the subject began with a sketch of the judicial evolution of the accountants' responsibility from 1895, when Justice Lindley held that the auditor was expected to state the true financial position of the company and could not be looked upon as an adviser or insurer, to 1931 when the Royal Mail Case occupied the stage.

Incidentally, the point was made that company audits had not been compulsory in England until 1900. From 1854 when the first British society of accountants was formed to 1900 when audits became compulsory by general statute there was a period of forty-six years. In the United States the first professional accountants society was formed in 1887. Forty-six years added to that date would mark 1933 as the year in which we should have seen audits made compulsory here—if the British precedent were to be followed.

With the Royal Mail Case as the center of the British paper the discussion revolved more or less about the propriety of secret reserves. Some opinion was clearly in favor of secret reserves on the ground that a full disclosure of all the facts would play into the hands of speculative stockholders whose interest was not in the company's welfare but rather in the market quotations for its shares. Other opinion was against secret reserves on general principles and held that the balance sheet was of little value as a true picture of company affairs unless accompanied by a true profit and loss statement.

It would seem from this that England as well as the United States is awakening to the basic importance of correctly calculated earned income in comparison to the unsupported balance sheet. All is not earnings which finds its way into balance sheet surpluses.

The discussion of depreciation, besides indicating that opinion favored maintenance of paid-in capital rather than maintenance of so-called economic purchasing power, brought out certain differences between British and American Tax practices regarding depreciation, each case no doubt reflecting the prevailing business practice in the respective countries. The English have the option of expression depreciation in terms of wear and tear, or renewals; they most commonly use the reducing balance method of calculating depreciation; obsolescence is deducted when sustained rather than being allowed for in the depreciation rate.

The titles of the other papers indicate their content. Sir Josiah Stamp's paper on International Finance was a reflection of the current interest in the problems before the London Economic Conference which was sitting at that time, and much the same could be said for the paper on foreign exchange. Professor Annan's paper on Accounting as an Aid to Commerce was mainly a plea for a broader vision of accounting service and the greater use of trained accountants—and statistics— on business enterprises. It should be particularly interesting to Americans that 700 accountants in Great Britain are on the directorate of 2,500 joint stock companies. In the discussion there was no hesitancy to take the auditor to task for some of his shortcomings. He was accused of having gained his status because he was forced upon business by governments, banks and exchanges rather than through the contributions he could make to the enterpriser's profit making activities. This, it was thought, tended to make him too easily content to give what the law required and too prone to think more of "limiting our liability" than furthering the clients' interests.

As is to be expected in a detailed report of discussions from the convention floor, the book is slow reading because of the repetition it contains and a trial to certain temperaments because of the unending exchange of verbal compliments. But a congress such as this is not designed to produce treatises; rather the aim is to create the opportunity to exchange experiences, compare notes, and, on the whole, find out that the other fellow usually has as good a reason for his practices and preferences as one has for his own.

A. C. Littleton

*University of Illinois*

# UNIVERSITY NOTES

### University of California at Los Angeles

Professor Ira N. Frisbee addressed the Los Angeles chapter of the National Association of Cost Accountants in November on the subject of presentation of cost data to management.

Graduate seminars in accounting are being planned for 1934–35, to be conducted by Professors Noble and Frisbee.

### University of Denver

Mr. Louis C. Linck, assistant professor of accounting and lecturer on income taxes, is leaving the department. Mr. John G. Larson has been added to the staff as lecturer on cost accounting and Mr. George T. Evans as lecturer on income tax.

Associate Professor Frank C. Onstott has been promoted to the rank of Professor of Accounting.

### University of Florida

Professor H. W. Gray is on leave of absence for the second semester. Dr. Paul M. Green of the University of Illinois will be acting Professor of Accounting in Mr. Gray's absence.

### University of Illinois

The University of Illinois has recently decided to offer courses by correspondence for the first time in its history. The first student to enrol for this new division registered for a course in elementary accounting. He is the father of one of the recent accounting graduates of the University.

### University of Iowa

Assistant Professor Harry H. Wade is publishing a textbook in elementary accounting for engineering and other professional students. The book will appear this spring as one of the Wiley Accounting Series, edited by Professor H. T. Scovill.

### University of Minnesota

Under the various student aid and CWA plans two students have been assigned to the accounting department to aid in preparing and grading examinations and problems. Objective tests are being developed in a number of courses.

A bulletin on the Employment Stabilization Institute at the University has just been prepared by Professors Bird and Paterson of the Psychology department entitled "Commercial Correspondence Courses and Occupational Adjustments of Men." The bulletin contains some interesting analyses of the results of correspondence courses taken by some 295 individuals. Data on the number completing courses in accounting and on the cost of such courses will be of interest to accounting instructors.

### University of Montana

Dean Line has been appointed chairman of the federal committee making a study of wages and salary costs for the relief work in western Montana. A number of field workers are at work collecting data for the report.

A state income tax law has been passed for Montana, returns for which must be filed before April 15.

### Ohio University (Athens)

Mr. R. F. Bishop, C.P.A., of Columbus, Ohio, has been giving the courses in Cost Accounting and in C.P.A. Problems this year.

### University of Oklahoma

Professor Berrigan, reaching the age of 70, has been placed on a half time basis. Professor Newton has been made head of the department. The courses in accounting are being changed from five hours to three. The elementary course will be a two quarter course of three hours and the intermediate and advanced courses will be one quarter courses of three hours each.

An accounting club was recently organized and out of town speakers will appear on its program.

### Texas Agricultural and Mechanical College

Mr. J. O. Gragg, a former instructor in the department, is now in the Austin office of the Reconstruction Finance Corporation. The department has two new graduate assistants, Mr. W. O. Lackie and Mr. W. M. Sompson.

Mr. T. W. Leland, head of the department of Accounting and Statistics has been elected president of the Texas Society of Certified Public Accountants.

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